L. R. B. & M. JOURNAL

VOLUME NINETEEN NOVEMBER, 1938 NUMBER FIVE

Federal Taxes on Income and Profits

By ROBERT H. MONTGOMERY

If Lewis Carroll were alive I would ask him to write another "Alice in Wonderland." I could supply sufficient incongruous and grotesque incidents dealing with the federal taxation of income and profits to fill a book—and a very funny book it would be.

We could start with the so-called income tax of 1909. It was administered and collected as an income tax, but it was not an income tax law at all. It was an excise tax of 1 per cent. imposed on the net income contained in current cash receipts. The ordinary layman might say: "What is funny about that?" but it is funny. Back in 1909 the public accountants took it very seriously and opposed the law on the ground that it could not be administered. The accountants were scolded by the Attorney General, the law was passed and forgotten. Regulations were drawn which ignored the cash receipts and payments provisions and imposed the tax on ordinary net income under the accrual system of accounting.

The joke was that the accountants started a fight in 1909 which rages unabated to this day. The fight is to have a simple income tax law. In their stubborn honest way, the accountants lose sight of the fact that in the silly incomprehensible laws started in 1909 and still on the statute books, are nuggets of the purest gold. Between 1909 and 1917 it didn't make much difference. The rates were so low that the differences between taxpayers and the government were hardly worth fighting about.

It was during those years that, rather accidentally, I was forced into a study of federal tax laws. I was Chairman of the Federal Legislation Committee of the American Association of Public Accountants and was actively engaged in Washington when the 1913 law was in the making. I appeared several times before the Ways and Means Committee, particularly in connection with the fiscal year question. The 1909 law required returns for calendar years and many clients changed from natural fiscal years to unnatural ones. In order to stem the tide we worked hard to provide for optional closings and finally succeeded. In 1913 I became acquainted with Cordell Hull, then

an active member of the Ways and Means Committee of the House. Our relations were close and pleasant as he was intelligent and reasonable.

After Mr. Hull was elected to the Senate he was equally approachable and on several occasions was definitely helpful in connection with pending income tax legislation. It is my recollection that when the House voted to charge 6% on additional assessments and proposed to allow taxpayers 3% on refunds, I pointed out to Senator Hull how grossly unfair such a provision would be. I explained that in many cases an additional assessment one year was entirely offset by a refund in another year, occasioned by a mere shifting of income or deductions from one year to another. The Senator wrote me that he understood the unfairness and as the proposal was not enacted into law I think he may be entitled to the credit. The Senate, however, does not originate tax bills so that his influence was not the same as when he was on the Ways and Means Committee in the House. Since he has been appointed Secretary of State, I have, of course, not taken up any tax matters with him but I shall never forget that during his long service in the House and Senate he was willing at all times to discuss the merits of any change in the income tax law and was always willing to listen to my story.

Alice would have liked the excess and war profits tax. Many of the silly provisions of our federal tax laws have arisen because of the jealousy between the House and the Senate. The House has never written a bill which pleased the Senate. In fighting out their differences, they try to graft apples on peach trees and produce lemons. I remember one famous section in the 1918 law. About that time I was writing a book and I attempted to explain the law. A lot of it didn't make sense but could be explained by the context, but that one section couldn't. In desperation as the printer was yelling for copy, I went to Washington and consulted Doctor Adams, of Yale, who was acting as an adviser to the Treasury. He finally said, "Your problem is insoluble." It seemed that, when the Senate struck out most of the House bill and superimposed one of its own, that one section was forgotten, so it stuck and just didn't mean anything.

One of our favorite playthings, and one which would have pleased Alice, was the distinction between admissible and inadmissible assets in computing invested capital. With our minds still hazy over general distinctions we were confronted with the necessity of doing something with inadmissible assets which were deemed to be admissible, and this was a very different thing from inadmissible assets which were not deemed to be inadmissible.

When I was secretary of the War

Policies Commission I drafted a war profits bill which would take the profits out of war. It was so simple that any one of our clients could understand it. When I say that I say a mouthful! Compare it with the 100 page monstrosity introduced at the latest session of Congress. On second thought, don't bother. My draft had a decent burial. Let it remain in the obsolete files division of the War Department.

Well, we tried to be helpful in all laws down to date. Take the 1936 and 1938 laws (whether you like it or not, take them!). Who could believe that corporations would be compelled to pay a tax on undistributed profits when they had no profits, and when told that you can escape the undistributed profits tax by paying out all your profits in dividends, you find that the dividends you pay are not taxable to recipients because out of capital, so you must pay the undistributed profits tax on your profits although you paid them all out in dividends.

And Alice would become very sad and would say: "How you boys must have suffered from 1913 to 1938. Did you lose all your money in fighting those obnoxious taxes and in trying to simplify the tax structure?" Wouldn't the accountants' faces have been red when they were compelled to say to Alice that the worse the laws became, the more money the accountants made, because no one understood the laws, but the accountants talked more about them than the lawyers, so the poor taxpayers who knew less than nothing were compelled to hire the accountants or the taxpayers would have had nothing left to pay the lawyers to keep them out of jail.

And then Alice would ask: "But why didn't some smart person suggest that the law merely require all corporations and other business entities to pay taxes on the net income shown by their books, and approved by certified public accountants?" And the answer would be "Congress does not work that way. If it isn't complicated, it must be wrong."

As a matter of fact such a law *would* work. But we need not be scared. True, it would reduce our tax practice 90% but we can expect more rather than less complications. Congress will not be guided by any rule of reason, and particularly will not be guided by accountants.

We can look forward with confidence, high hopes and undiminished personal incomes to the 1939 Federal Revenue Act. As usual the House will do one thing, the Senate another, the Treasury will make some good suggestions which will not be adopted, the President will attempt to raise the rates on undistributed profits and capital gains, and it will all work out just as Alice knows it will.

NEW YORK, N. Y.

Accounting Aspects of the Automobile Industry

By Donald M. Russell

The history of the automobile industry in the United States, since its beginning in the closing years of the nineteenth century, has been one of amazing development. In its infancy the industry produced few automobiles, and only the wealthy could afford to own them. By 1910 the number of producers had increased considerably and in that year they produced about 125,000 cars. Ten years later the number of units manufactured, including trucks, had increased to 2,250,000 and the aggregate number of motor vehicles produced in the United States and Canada had reached almost 14,500,000. The all-time peak of production occurred in 1929 when more than 5,600,000 units (4,800,000 passenger and 800,000 commercial vehicles) were produced in the United States and Canada; the corresponding figures for 1937 were 5,000,000 units (4,050,000 passenger and 950,000 commercial vehicles).

Concentration is an outstanding characteristic of the industry, both as to location of plants and domination of management. In contrast with the growth in the number of cars manufactured there has been a striking decrease in number of manufacturers. In 1924, the Department of Commerce reports, there were 99 companies engaged in making passenger cars. In 1937 the number had dwindled to 24. The "Big Three," together with relatively few independents, comprise the entire field of passenger car manufacturers today. There is, however, a larger number of independent truck manufacturing companies.

Mass Production

Although, at first, motor vehicles were a luxury, the very nature of the product soon brought tremendous public appeal in consequence of which some of the best engineering, manufacturing, merchandising, organizing and financial brains were drawn into the industry. The result was mass production on a scale and under economical methods never before contemplated. This development of production methods, together with widespread adoption of instalment financing, enabled the companies to market their products at prices and under terms within the reach of almost every wage earner.

Early in the history of the industry the policy of selling motor vehicles on sight drafts, with bills-

of-lading attached, was adopted for domestic shipments. In the export trade, sales are usually made on drafts against previously established letters of credit. A few manufacturers at first resorted to distribution through selling branches located in the populous centers, but before the 1929 depression, sales were being made almost exclusively through independent distributor-dealer organizations. Credit corporations furnish the necessary dealers' and consumers' financing and the manufacturers are thus relieved of the necessity of financing and accounting for the ultimate distribution of their products.

The magnitude of the transactions that each company must handle has naturally influenced the accounting practices followed. Hence, the manufacturers have been compelled to develop and use standards of performance and standards of cost; more so, perhaps, than in any other industry. There are, however, very few accounting procedures which differ substantially, or in principle, from those in common use by all large manufacturers in other industries organized for mass production.

Car Costs

Specification cost rather than job cost is the generally adopted method of costing the product. A car-cost summary for each model is assembled before production is started, based on contracts for the purchase of parts, on experience and on engineering estimates for all operations. As production proceeds, these costs are assembled again, as soon as possible, and from time to time thereafter they are modified for changes in design and corrected for changes in wages and material costs. Such standard costs have proven satisfactory and reliable because the underlying manufacturing operations have been standardized.

Minute-Costs

The basic tool of wage control is the time study, applied to each direct labor operation. Variances are expressed in terms of minute-costs, i.e., total minutes of direct labor are divided by the number of units produced to determine actual minutes per unit and the results are compared with the standard minutes allowed.

Obsolescence of Machinery

The automobile manufacturers have been in the forefront in the development of automatic machinery, and are recognized leaders in such matters as continuous material flow, production control, storeskeeping, factory budgeting and wage plans. The enterprise which characterizes automobile manufacturers is also responsible for one of the industry's accounting problems, namely, the obsolescence factor of machinery and equipment. Management thinks little of discarding relatively new, expensive machines

in favor of newer, more economical models before the costs of the first machines have been completely recouped through periodic depreciation charges. Because of this, the wise manufacturer aims to make liberal provision for depreciation.

Wage Plans

Even before 1937, when labor unrest resulted in the abandonment of piece-work and wage incentive plans in other industries, automobile manufacturers had returned to the day-work method. Management has found that production incentives did not need to be built into the payroll procedure. The same results have been achieved with vastly less bookkeeping by means of time studies, analyses of each job, placing responsibility on the group leaders, and the education of group leaders, foremen and department heads by furnishing them with daily (and in some instances hourly) production reports.

Serious study has been given in the industry, particularly since 1935, to "annual-wage" plans and to other devices to stabilize employment and employee income. An outright guaranty of an annual wage appears impossible in an industry whose output dropped from 5,600,000 cars in 1929 to only 1,430,000 cars in 1932. The new plan announced recently by General Motors Corporation, whereby employees meeting certain length of service requirements may obtain advances to bring their part-time hourly pay up to a specified standard (less than full-time), repaying such advances out of subsequent earnings in excess of the specified standard, represents a distinct contribution to the cause of stable employee-income and thus to stable business conditions.

Tools, Dies, etc.

An important accounting problem arises from the trade's demand for frequent changes in styling and the practice of bringing out new models annually. Each new model may not require major engine or chassis changes, but changes in body styles, and even in radiators and louvers, involve enormous expenditures for dies, fixtures and special tools.

Frequently such expenditures must be recovered entirely from the proceeds of a single model, although the tool equipment may be rebuilt or adapted for several models. The industry has not yet agreed as to the proper accounting treatment to be accorded such costs, but generally speaking, all companies follow the practice of spreading the total cost over the production receiving the benefit. The most popular, and certainly the preferable, method is to allocate the total cost pertaining to a model on unit basis over the period of quantity production. The possible physical life of this type of equipment is a minor consideration and the probable economic life the major and vital consideration in de-

termining the amounts to be expensed.

Overhead During "Tooling-Up" Period

The annual change of models requires a rather lengthy period for "tooling-up" during which production is at a standstill, all effort being directed toward installing new dies, machines, procedures and routines. The period may vary from one to three months, depending upon the extent of the changes, engineering difficulties, etc. In one case the change-over from an old to a new model forced the manufacturer to halt production for over a year. Some companies charge off the overhead expense during this "tooling-up" period in the months in which it is incurred and others defer these expenses on the theory that they constitute development costs and amortize them during the remainder of the model period, usually on a per car basis.

Natural Business Year

The "tooling-up" period marks the end of the natural business year in the automobile industry. At the beginning of this period the inventories for the previous models have been either exhausted or reduced to a minimum, and the materials for the new models have not been received at the plants. At that time the current assets are more liquid, and the liabilities are at a minimum.

The calendars for the scheduling of production activities and for determining the "tooling-up" period are computed backwards from the dates of the New York automobile shows at which the new models are first exhibited to the public. In 1935 and prior these shows were held during January. Acting on the suggestion of President Roosevelt the show for the 1936 models was advanced approximately two months to the first week in November, 1935, and subsequent shows have been held about that time each year. This change has advanced the "tooling-up" periods to August and September so that September 30th is now indicated as the best terminal date for fiscal years in this industry.

Under these circumstances it seems strange that only one producer in the industry has adopted September 30th as the end of its fiscal year, and that company made the change during the year 1937. It may be that other companies will soon follow the lead. One reason frequently given for the failure to adopt September 30th as the close of the fiscal year is that the manufacturers prefer to test the permanency of the advanced dates for the automobile shows before making the change.

Inventory Turnover

Because of the extent to which automobile manufacturers have developed the plan of continuous material flow and because of their highly efficient methods of produc-

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Cost Accounting Problems in the Canning Industry

By George R. Keast

The art of preserving foodstuffs in air-tight containers is of commercial origin, and it dates back to the beginning of the nineteenth century. Even as early as the Civil War days it had reached relatively substantial proportions as an industry, and today it has an annual output the value of which is rapidly approaching the billion dollar mark. The canning or packing industry now processes nearly all kinds of foodstuffs, including fruits, vegetables, seafoods, meats, and many specialties. Although the various branches of the industry have numerous features in common, it is intended here to confine the observations largely to the canning of fruits and vegetables.

Importance of Uniform Methods of Cost Determination

Today there are many hundred private enterprises engaged in the canning of fruits and vegetables, and the character of their operations ranges from modified forms of home canning to the large scale operations in multiple line canning factories. These private enterprises are spread throughout most of the 48 states and the territory of Hawaii, although the greatest concentration of volume and large scale operations will be found in the State of California. In the main, the canning business is keenly competitive, not only in the distribution of finished goods in the markets of the world, but also in the purchase of raw products for processing.

Being closely allied to the agricultural industry, the canning industry shares the doubtful distinction of resisting the normal economic elimination of unprofitable units or excess facilities, but without agriculture's dubious benefit of subsidy or concern by the government. Although its products are staple goods, the canning industry has had a checkered financial career, and harmony and stability have been conspicuous by their absence. As a class, canners are highly individualistic, a characteristic which militates against cooperation. The adoption generally of uniform methods of cost determination would tend to have a stabilizing influence.

Cost accounting in the canning industry, as in most industries, serves two distinct purposes; namely, the determination of costs and the preparation of cost estimates. The first phase covers the assembly of costs upon which the operating statements are based, and also provides the man-

agement with data for the control of operations.

The second phase deals with the preparation of preliminary cost estimates for the purpose of guiding the management in the formulation of its policies with respect to the prices at which canned goods are to be offered for sale. It has long been the custom in the canning industry to establish sales prices and accept sales orders before commencement of packing operations; consequently, it is necessary to forecast costs. Not only should these forecasts be reliable, but from the standpoint of intelligent and healthy competition they should be drawn up in a substantially uniform manner by all canners.

Inasmuch as nearly all elements of cost in the canning industry are to a greater or lesser degree joint costs for all sizes and grades, and to some extent for all commodities, it is obvious that unless there is substantial uniformity in all essentials, wide variations of purely artificial nature are inevitable. Consequently in the absence of uniformity, reference to costs in connection with sales policies becomes largely a futile gesture, for rarely is one canner uniformly high or low, but instead certain items are above while others are below the average of the industry as a whole. Experience has shown that the assertedly low cost items of the various canners serve to depress general market levels.

Uniform cost accounting methods should prove useful in the presentation of properly accredited cost data in the course of concerted negotiations with growers. Heretofore, acceptable data have not been available and consequently the establishment of the purchase price of raw product has been mostly a matter of blind bargaining. It is not meant to imply that uniform cost methods alone can remedy the situation, but a knowledge of costs and a convincing presentation should go a long way toward bringing about intelligently conceived and equitable arrangements. Over a period of time the canner is entitled to a reasonable profit, but at the same time there should be no excessive profits at the expense of the growers or consumers.

For some years past, the University of California has been conducting some extremely helpful studies of marketing conditions of certain leading commodities produced in the State of California. From the results of these studies, it is now possible to determine within certain fairly well defined limits the quantity of canned goods which should be packed in order to maintain a well-balanced market. In the main, this has indicated the level which will yield the highest return to the grower. If these studies are properly coordinated with reliable data regarding processing costs, normally it will be possible to determine raw product prices which will serve

the best interests of both the canner and the grower.

Reliable cost data should also contribute much to an intelligent approach to, and a mutually satisfactory solution of, labor problems. The industry is vulnerable in that raw product must be harvested and canned within a relatively brief season and any delay awaiting settlement of controversies would mean serious losses to both growers and canners. Consequently it behooves the industry to establish a procedure for the development of costs which are unassailable, and which will indicate limitations beyond which labor demands are unreasonable.

As a vehicle for the stabilization of conditions in the distribution market, the determination of equitable prices of raw materials, and the promotion of amicable labor relations, a uniform method for cost determination seems well nigh indispensable to the welfare of the industry.

As a constructive step in this direction, the trade associations in California some time ago embarked upon a program designed to promote uniformity in the methods of cost determination among their members and other California canners. Late in 1937 under the stress of an emergency arising out of overproduction of peaches, a large number of California canners united in a program, the objective of which is to encourage stabilization primarily through adequate and dependable information concerning costs.

Cost Problems Peculiar to the Canning Industry

Present day canning requires uniformity of product and careful selection or grading as to texture, color, size, etc. Moreover, the consumer demands that the various grades be available in a range of can sizes. Consequently, certain fruits are now produced in as many as twenty different sizes and grades for each style of pack. Thus we find that clingstone peaches, with two principal styles of pack (halves and sliced), are obtainable in an assortment of some forty different sizes and grades; and apricots, with four principal styles of pack (halves-unpeeled, halves-peeled, whole-unpeeled, and whole-peeled), are turned out in sixty to eighty different sizes and grades. Asparagus runs in excess of one hundred separate and distinct items. Such a multiplicity of sizes and grades within commodities should convey some idea of the complex nature of the cost accounting problem.

The cost of raw product and many other elements of cost which are not directly apportionable to sizes and grades must be apportioned on some appropriate basis. In fact, except for cans, there are very few items of cost which are assignable directly to specific sizes or grades, so that for the most part some pre-

determined or arbitrary bases of apportionment must be resorted to.

A further complicating factor in this problem of joint costs is the fact that in many canneries a number of commodities are processed, some of them simultaneously. Therefore, while this problem of apportioning joint costs is not altogether unique, it is doubtful whether it will be found on such an extensive scale in most other industries.

It may readily be seen that in the absence of uniform methods as between canneries the selective loading or lightening of joint costs assessed to the individual items of pack will produce undue differences in cost.

Perhaps the most troublesome element of cost from an accounting standpoint is that of raw product. The first problem concerns the application of the cost of the incoming ungraded raw product to the resulting grades of canned goods, since most varieties of fruits and vegetables are packed in a number of grades. If the cost of raw product, which is almost invariably purchased at a flat price per ton, were distributed without discrimination, the higher grades would benefit at the expense of the lower grades. For all practical purposes, the resulting loss in the lower grades, insofar as it may be attributable to the raw product cost allocated thereto, would properly constitute an additional cost of the higher grades. In other words, if it is necessary to pack a full line of grades, the loss on the lower grades rightfully constitutes an additional cost of the higher grades. On the other hand, if the lower grades are not essential to the business, prudent management would logically discontinue the unprofitable lines, in which event the higher grades would be chargeable with the entire cost of raw product. In the final analysis, therefore, the higher grades are in effect forced to carry some or all of the cost of substandard raw product. Therefore, the cost of raw product should be distributed over the several grades on some equitable basis so that the higher grades will bear a higher unit cost than the lower grades.

Broadly speaking, the cost of ungraded raw product should be apportioned to the resulting grades of canned goods on a sliding scale approximating the price range which would exist if it were possible to buy perfectly graded raw product and pack it accordingly. Under such conditions the free play of economic forces would determine the prices of the various grades, which over a period of time would be at levels which would yield a profit, although not necessarily a uniform rate of profit for all grades. In other words, the price which raw product may command over a period of time will be governed largely by the profit factor. Therefore, the economic values of the various grades of raw product may be deduced from the margins between selling prices and total costs of canned goods. The costs

should represent a fair apportionment of the total cost of doing business exclusive, however, of any provision for raw product cost in order that the margins will represent the spread available for raw product cost as well as profit for each of the grades.

In the absence of reliable detailed statistics for the industry as a whole, and by reason of various influences such as unbalanced production, peculiar types of outlets, distress selling, and other individual characteristics of the business of any single packer, a differentiation in grades is as yet not altogether susceptible of precise determination along scientific lines. Therefore, it is necessary to resort to an arbitrary reckoning of the experience of the industry.

Grade differentials, frequently known as ratios of values, are nothing more than schedules showing relative values. Their purpose is to make each grade share the raw product cost roughly in proportion to its "ability to bear."

In addition to the determination of the costs assignable to the various grades, it is necessary to calculate the weight of raw product required for the various can sizes. The fact that the incoming raw product cannot be identified except as a whole with the resulting canned product by sizes and grades, or with the specialty products to which raw product may have been diverted presents further difficulties. It is not possible to determine accurately the quantity of raw product required for any specific size or grade. That is to say, the loss in weight through cutting, peeling, pitting, stemming, coring, trimming, slicing, dicing, evaporation, culls, waste, or other shrinkage cannot be followed through exactly and assigned to the prepared weights of any size or grade. Therefore, it is necessary to establish a schedule of factors which will reflect the relationships by means of which the raw product contents of the cans for the several styles of pack within each commodity may be computed on a uniform basis. The initial step requires the determination of the filling weights of the various sizes and styles of pack of each commodity. The second step requires a determination of the variations in the preparation losses in the several styles of pack of each commodity. In other words, it is necessary to establish a table of modifying factors to convert the filling weights of all styles of pack within each commodity to a uniform basis.

These brief comments are indicative of the general method of approach to all elements of cost. The cost problems are quite involved, and this perhaps has been one of the barriers to a solution of the problem of stabilization of an industry which has been in existence for such a long time, and which in other matters has made such notable progress.

San Francisco, Calif.

Certain Accounting Practices in the Nonferrous Metal Industry

By Norman J. Lenhart

It sometimes happens that accounting practices which may have had their origin in their apparent suitability for certain industries are in fact applicable to many others.

Inventory Methods

An example in point is the normal or base stock method of inventory valuation. Under this method that part of its inventory which a concern considers it must carry at all times under expected operating conditions is valued at low prices, usually unchanged from year to year, and usually substantially less than the prices used at the same date in valuing identical material in excess of the so-called normal or base stock.

For some years, smelting and refining companies, as well as certain other producers, processors or manufacturers of so-called basic raw materials, have made more or less use of the normal or base stock method of inventory valuation. It is considered applicable to smelting and refining companies for the following reasons:

1. The processes are slow and inventory amounts are large in relation to other asset amounts.
2. The costs of smelting and refining represent a relatively small percentage of the market values of the metals processed so that the fluctuations in the market prices of metals have a more important relative effect upon operating results than have the fluctuations of raw material prices in many other industries.
3. Whereas in some industries fluctuations in prices of raw materials may not be immediately reflected in corresponding changes in selling prices, in the case of smelters and refiners, purchases and sales of metal contracts are generally made upon the basis of the same market quotations.
4. Unless and until operations close or are curtailed to a point where inventory quantities are less than the theoretical normal or base stock, the continuous maintenance, as hedges, of future sales on metal exchanges would prove expensive and be of little practicable benefit insofar as such normal or base stock quantities are concerned. It is probable that most smelters and refineries now operating have at no time throughout their histories completely suspended operations. It should be noted that whereas companies in certain other industries could prob-

> ably complete the manufacture of most of their raw materials, without excessive cost, if a shut-down were contemplated, in the case of smelters and refiners there exists a basic quantity of metal which cannot be recovered except at excessive cost if the plants were to be closed down. The profitable production of refined metals is frequently dependent upon the proper mixing or blending of different kinds of raw materials, all of which necessary components may not be immediately available or readily procurable for an economical recovery of the metals in an inventory of raw materials in the event of a prospective shut-down.

The normal or base stock method of inventory valuation seems to be gaining in use and recognition but as yet it cannot definitely be called a generally accepted method.

What may be considered the most often used method of inventory valuation, and one accepted by the Treasury Department for income tax purposes, is the lower of cost or market computed on a first-in, first-out basis. The use of the first-in, first-out basis may result in the determination of profits which are immediately reinvested in perhaps the same quantity of inventory as has been previously carried, but at higher prices. When a drop in prices ultimately arrives, it may be that all of the profits apparently realized and then reinvested in higher priced inventories are lost within a very short time. In most instances, the use of first-in, first-out exaggerates both the recorded profits in a period of rising prices and the recorded losses in a period of falling prices.

The normal or base stock method of inventory valuation is an attempt to minimize or avoid a substantial part of these exaggerations in profits and losses due to price fluctuations. Another method which has been the subject of considerable discussion during the last few years is the last-in, first-out method of costing sales and valuing the inventory at any date. The reasons usually advanced for the use of this method by smelting and refining companies are about the same as those advanced for the base or normal stock method except that, to a large degree, a lack of futures markets for hedging operations (a reason often advanced in support of the last-in, first-out method) does not exist. Although the last-in, first-out method to a degree accomplishes the desired purpose, it nevertheless does not protect a company against price declines below the inventory valuations of the earlier stock on hand.

Even those who have made use of the base or normal stock method have sometimes found that prices which may have been once determined as permanent for base or normal stock quantities have proved quite excessive in the light of subsequent developments. Consequently, it may be contended that the principle of cost (on whatever

basis determined) or market, whichever is lower, still should be retained by smelters and refiners as a method of inventory valuation control, especially with respect to quantities of metals against which firm sales orders do not exist.

A much restricted use by nonferrous metal smelters and refiners of the last-in, first-out inventory method for federal income tax purposes was granted for the first time in the Revenue Act of 1938. Under the present provisions, if this method is adopted, no effect can thereafter be given to market quotations if lower than cost. In other words, the present provisions permit the valuation by nonferrous metal smelters and refiners of certain inventories at cost determined on the basis of last-in, first-out but not at the lower of market or cost so determined.

Valuation of Inventories at Selling or Market Prices

While nonferrous metal smelting and refining companies have made considerable use of what may be regarded as conservative inventory practices such as the base or normal stock method and the last-in, first-out method, there is considerable use by such companies (and also by nonferrous metal mining companies) of valuation of inventories at market quotations or selling prices.

There can scarcely be any criticism of the valuation of gold at market quotations. Normally, gold is the equivalent of money and its value is not subject to frequent fluctuation. In this respect an inventory of gold is unique.

The case for silver is not as strong, unless the government of the country in which the enterprise is located is committed to accept all silver tendered. Even when such a condition does not exist, if the silver is merely a by-product recovered from ores primarily valuable for some other metal, there can probably be little objection to the valuation of a small quantity at market. If, however, silver is of primary importance and the government is not committed to its purchase, objection may be made to such valuation on the ground that world silver prices do fluctuate and there may not be assurance of an immediate market for all silver which may be offered for sale. However, it is probable that next to gold, a better case can be made for the valuation of silver at market prices than any other metal. If silver is a primary metal and is carried in the balance sheet at market quotations, it would seem desirable to indicate cost parenthetically.

It should be noted that many mining companies have no facilities for smelting or refining their productions and sell such productions to smelting and refining companies.

During certain periods, usually when inventories remain at quantities considered normal, sales of metals are made by smelting and re-

fining companies on the basis of the same price as has been applied to the metal contents of ore purchased in determining the price paid for such ore. Such ideal conditions, however, rarely exist and the intake and sales prices (as well as inventory quantities) fluctuate from time to time. Nevertheless, except in periods when large excess stocks are accumulated, there is usually no material difference between the intake base prices and the selling prices.

One reason often advanced for the use of selling prices for smelting and refining company inventories is that cancellation of a metal sales contract is almost unheard of, even in periods of severe declines in market quotations. While deferments of delivery dates for metals are sometimes made, complete cancellations of contracts are extremely rare.

Certain Features of Financial Statements

The method of presenting income accounts of smelting and refining companies varies. Two factors are involved in the income account of a smelting or refining company. The first is the ordinary operating income resulting from the smelting and refining of ores, concentrates, etc. The second relates to the fluctuations in the metal market between the time the metals are purchased in the form of ore or concentrates, and the time the refined metals are sold. As noted previously herein, the use of the normal or base stock or last-in, first-out inventory methods tends to minimize the effect of such market fluctuations by a low valuation for a substantial part of the inventory or by closely relating current cost prices to current sales prices. Whether a smelting company's sales are the actual sales of metals or the gross amount received for treatment is a debatable point. The ideal income account would probably show the gross amount received for smelting and refining operations and the cost thereof and, separately, the gross sales of metals and the cost or intake prices of such metals. However, such a separation of factors is usually not made in the income accounts of smelting and refining companies. A complicating factor is that in many cases the smelting or refining company is also engaged in mining operations so that, in order to be completely informative, the income account should have a third major classification. Practical considerations usually prevent such detailed classification.

Payments by a smelting and refining company to a mining company are made upon the basis of the current market quotations for the various metals contained in the mining company's ores or concentrates, less allowances for the treatment charges, smelting and refining profit, etc. The difference between the valuation at market quotations and the amount actually paid to the

mining company is usually described as the margin. A customary accounting procedure is to set up in the inventory records the abovementioned valuation at current market quotations of the metal content of ores or concentrates and to credit the difference between this amount and the amount actually paid to a margin account representing, in effect, deferred income. For balance sheet purposes, the amount of the margin unearned is usually deducted from the inventory.

Since most ores and concentrates delivered to a smelting company contain a number of metals, detailed metallurgical records must be maintained in order that the efficiency of the smelter and refinery operations may be checked. It is not practicable to take physical inventories of ore stocks at a smelter. A physical inventory of metals in a refinery is not quite so difficult because of the more or less uniformly high metal content of bullion or other materials for refining.

Depletion

Many mining companies do not treat depletion as a cost of production but rather as a direct charge to income or surplus. Some companies ignore any charge for depletion. Frequently depletion is computed upon units of metals sold. This practice has, no doubt, been fostered by United States income tax regulations which have permitted either percentage depletion or unit depletion determined by multiplying the unit amount for depletion by the number of units sold within the tax period. The practice of taking depletion based upon units sold has no material bearing upon the income account unless the inventory cost, inclusive of depletion, exceeds the market price. If the cost of the inventory is or should be written down to market and there remains in the balance sheet a certain amount of property valuation applicable to mineral mined but unsold, it is obvious that there is yet a further charge against income account or surplus with respect to depletion on such mined but unsold mineral. From a balance sheet standpoint, so long as a mining company's inventories are carried at cost the usual effect of the omission of depletion upon production until sold is to carry an amount in the fixed asset section of the balance sheet which might properly be included in the current asset section.

The problem of depletion in the case of mining companies may lead to many complications. The valuation of a mine depends upon a great number of factors, such as metal prices, labor costs, material and transportation costs, estimated metal content of the property, etc. The metal content of almost any mine is very difficult of determination with any degree of accuracy, with the result that depletion based upon the amount per unit of extraction can rarely be even approximately exact.

It sometimes develops that companies have amortized the book value of the properties owned long before such properties are exhausted. Some companies have adopted the system of making periodic revaluations of unmined ore. Some companies capitalize development expenditures and some do not. As a result of these varying practices, the published statements of mining companies are particularly difficult of comparison.

The United States revenue acts have provided that, for income tax purposes, depletion may be computed on the basis of a percentage of gross income with a limitation based on net income. This is not a particularly new idea, since in the past mining companies which have been unable to determine a reasonably accurate unit depletion rate have sometimes created reserves against property costs by an annual allowance bearing some relation to the operating results. Such a procedure is, of course, completely arbitrary. While it would appear that almost any depletion allowance is bound from the very nature of the enterprise to be subject to a greater factor of inaccuracy than ordinary business computations, it would seem that determination of depletion as a percentage of income is perhaps the least desirable method for use in published financial statements. The use of net income as the basis for such a computation seems even less desirable than the use of gross income.

NEW YORK, N. Y.

Motion Picture Accounting Problems

By Walter B. Gibson

In Victor Herbert's operetta, "The Red Mill," the lines in one of the songs ran like this:

"You never find two alike at any one time,
And you never find one alike twice."

The song referred to women, and whether or not the slightly pessimistic sentiment was justified in that connection, its application to motion picture problems and solutions is almost completely apropos.

The picture business seems never to have run out of problems, nor has it been short on solutions. The trouble is that the problems refuse to stay the same for very long (except that everlasting fundamental one, "Artistic temperament versus cost control") and the solutions differ not only as between companies but from year to year in the same company. Perhaps this is only natural. Not only is the industry young, but it is complicated. Its changes and developments have been so rapid and so drastic in its relatively few years, that things have not had time to jell.

When will standardization come? Not for a long time, perhaps. Not for lack of brains, because there are plenty of brains in all divisions of the industry and high grade abilities of all types. Too many brains, perhaps, and of too high quality to settle down into a reasonable rut and get things set and sufficiently static so that problems may be diagnosed, classified, and uniformity of treatment, accounting-wise, made effective.

Budgeting is important. The major companies and most of the independent producers forecast, at the beginning of the year, the number of pictures which are to be produced during the next twelve months' period. A lump sum is assigned tentatively to production costs, and the combined schedule of pictures to be produced and total maximum cost thereof is passed to the budget department which, working on the cost sheets of prior pictures and past experience coupled with current labor and material costs, attempts to prognosticate accurately the cost of each picture. The lump sum is then divided up between the pictures, and the size of budget assigned to each picture depends upon the classification of the picture, the magnitude of the stars to be used therein, the diversity of the sets and locations, and the probable length of shooting time. It will be seen that a temperamental delay will nullify the budget department's estimate.

The picture year usually begins

September 1st and each picture to be made and released during the year is assigned a rank in the production scale for that year. This position, to some extent, controls not only the allowable budget but also the price to distributor and exhibitor, i.e., superfeatures would command larger budget allocations and higher distributor percentages than the ordinary features and program pictures.

The budgeting, although done by experts, is only an approximation and seldom strikes closely to the actual negative cost. However, it does act as a checkrein on spending tendencies and helps to force an economy which might otherwise be lacking.

The four functional divisions of the industry may be best expressed by the terms: producer, studio, distributor, and exhibitor. As a rule the producer and studio are under the same management, although there are existing organizations functioning as studios only. Yet there is a decided difference in methods of operation and accounting problems and, for the purposes of this article, the studio, or "backlot," is treated as a separate unit.

The producer selects and arranges the story material, employs writers, assistant producers, actors, and cameramen and does the greater part of the creative work. The studio performs the mechanical work of production, erects sets, employs labor, furnishes artists (or artisans) in music, painting, wardrobe, make-up, hairdressing, sound technique, and a thousand other fields, and contributes its own share of creative work such as special effects (a full-sized ship being battered on a storm-ridden reef) and appropriate musical composition. The distributor's field is to sell and distribute to the exhibitor.

The outstanding accounting problems of a studio cluster around the control and determination of costs, by pictures. The producer also has a cost problem, different in character from that of the studio, for his main problem is to hold his total cost on any picture in line with its hoped for revenue and, incidentally, to decide over what period such cost shall be amortized. The distributor, who works on a percentage basis, is indifferent to either cost or life of the picture, while the exhibitor, purchasing all product of the producer on predetermined rates, has an entirely different set of problems. In this article only the problems of the producer and the studio are discussed.

In a studio, which frequently is making several pictures simultaneously and deploying its physical equipment and technical staff from one picture to another, the main problem from an accounting standpoint is what and how much should be charged to any one picture? For example, how should one spread the cost of standard sets, or special sets designed for one picture but used

and re-used on other pictures? How about "props," wardrobes, overhead? Even the question of how to spread actors' salaries has probably not been finally answered. There are many methods of partial solution.

For instance, a studio may be organized as if it were a manufacturing plant selling to producers in accordance with plans furnished by the latter (there are several such integrated plants). Contracts are entered into specifying fees and rates for every class of service: cost plus per cent for ordinary labor and material, specified hourly rates for services of special employees and departments, specified daily rates for sound production (involving film, use of equipment and crew), rents for all conceivable kinds of equipment and space, flat costs for accommodation services, where the studio acts as purchasing agent or supplies electric current or water.

In other cases, where the studio and producer functions are merged or at least mingled, allocations of costs to specific pictures are on almost every conceivable basis, all affecting the final amount charged against the production.

The costs themselves, of course, range from the admittedly direct to the highly indirect. A studio desiring departmental costs primarily may design its cost accounts so that only direct charges for labor and material applicable to all pictures will be accumulated, and costs by productions will require a separate break-down. Set costs requiring the services of many departments require special work orders. As a rule a picture is charged in full for the cost of all sets, properties, and wardrobe made for it, regardless of any salvage value remaining, or their possible use in future pictures.

Under the classification of overhead falls a miscellany of costs, each with its problem of apportionment among the pictures produced. Obviously studio costs vary considerably with different types of pictures; a musical production, for instance, will show a large sum for salaries paid to musicians for which the actual studio overhead is negligible. For overhead distribution by pictures, the method of detailed analysis is generally impracticable. More favored methods have as a basis shooting hours or days, or sound hours (called channel hours) or days. Any method is empirical and open to discussion from an accounting standpoint.

One of the chief cost problems to the producer (as distinct from the studio) is the distribution of the salaries of highly paid employees. There is no set formula for this; the practice changes very rapidly and is determined by the types of contracts existing. At the present time, the majority of contracts with stars call for a fixed number of pictures within a given period, and the larger producers rarely find themselves faced with a write-off for failure to

produce the guaranteed number. Contracts with major stars frequently provide that they may not be loaned out. This practice of loaning out is common, however, with lesser lights, and is productive of considerable income to the lender.

Directors' contracts are following the form used for stars. There are a number of others such as assistant directors and cameramen on contract who may be used on any number of pictures. In these cases an apportionment is usually made annually or semiannually which is based on time.

Generally a ledger is kept for each contract employee, and his salary apportioned to pictures on as fair a basis as possible. There are occasional difficulties, as for instance, the preliminary training and tutoring of an imported star, which in one case at least, is reputed to have cost two hundred thousand dollars.

Unassigned time is generally considered overhead and is credited with income from loan outs. There have been cases where this account has shown a profit.

It was formerly common practice, and still is in at least one large company, to charge to the negative cost of the next picture all the accumulation of prior idle time for each individual employed. Under this method, it is possible that a director may actually want a contract player for a particular part in his picture and may turn down this player, even though available, owing to the large amount of idle time which the player may have built up and which must be charged against that player's next assignment, even before the picture starts.

This, naturally, would cut down the director's balance available under his budget and make it more difficult for him to obtain other things which he deems necessary to the production. Of course, the director's excuse is that the player is not quite suitable to the part. The most desired directors in the industry are those who can keep negative cost below budget, and no director wants to be branded as too expensive on his negative cost.

Story cost is usually carried as a deferred asset until such time as the story is used, sold or definitely rejected. But it should also be mentioned that accounting methods have caused stories, as well as actors, to be rejected or at least avoided by directors, simply because of heavy accumulation of prior costs. For example:

A story is purchased in novel form from an author, and at once several actors suitable for the major parts come to mind, and, if possible, are placed under contract. The story is then in the hands of writers who are to arrange it in scenario form. Perhaps these writers have been idle for some time, and thus their accumulated idle time is charged to story cost, at once, and to this, of course, is added the time spent in scenario preparation. Next, a director reads

the story, and works with the casting director arranging the players. All of their idle time prior to the moment of actual production is charged to negative cost. It will be seen that during this preliminary period, and by this method of accounting, a huge item may have accumulated against the cost of the picture.

In the problem of amortization of picture cost, the accountant is faced with an equation in which the unknown factors predominate. Past experience may serve as a fairly accurate guide with shorts or quickies, and the adoption of a fixed period of 26, 52, or 78 weeks for each picture may not cause disturbing fluctuations in the financial statements.

Such methods, however, can rarely be used with feature pictures, especially in view of the much greater cost of such pictures. It is safe to say that no one can predict, at the time of its release, the income or life of a picture.

A favored method of amortizing the costs of producing feature picture negatives is to write off weekly, on the basis of world wide prior experience, a certain percentage based upon such experience, which at the end of the 26th week would aggregate 75 per cent. of the cost and at the end of the 52nd week, 95 per cent. of the cost of a picture.

The positive film costs applicable to feature pictures distributed in the United States and Canada are amortized on the basis of the combined experience in those countries. Usually, 75 per cent. of the costs are written off by the end of the 13th week from the date of release and 95 per cent. by the end of the 26th week.

However, box office results are closely scrutinized and judged in comparison with previous releases. If, within a few weeks after release of a feature picture, it becomes apparent that revenue therefrom will not measure up to prior expectations, provision is made for additional amortization. Thus each picture determines its own amortization rate. This conservative method will appeal to accountants.

The entire costs of the positive films for distribution in foreign territories are usually charged to profit and loss upon release of such pictures for foreign distribution.

LOS ANGELES, CALIF.

Some Observations on Inventory Methods

By Walter A. Staub

The past quarter century has seen a marked development in methods of valuing inventories of raw materials, work in process and finished products. A number of influences have contributed thereto. One was the development of credit practice by commercial banks. While not minimizing at all the requirement for good character on the part of a prospective borrower on which the late J. P. Morgan was quoted as laying such stress, the increasing complexity and widespread extent of many business organizations, and the difficulty of knowing the actual situation of the borrower only through personal contact with him, led to an increasing requirement on the part of the banks for financial statements from borrowers. In the course of time this requirement was extended to a call for certification of the statements by independent public accountants, an idea of which the late James G. Cannon, president of the old Fourth National Bank in New York, was almost a lone advocate during the early years of the twentieth century. This has now become a requirement for rediscounting of commercial paper by the federal reserve banks.

Another influence tending toward better inventory practice was the introduction of the income tax, starting in a mild way when applied to corporations in 1909, extended to individuals in 1913, and supplemented by the heavy excess-profits tax beginning in 1917. Business men who had not previously been much interested in accounting or who, with natural optimism, had shown their earnings as high as possible, became very much interested in seeing that their taxable net income was not overstated. Both of these influences led to a wider acceptance and better understanding of the rule of "cost or market, whichever is lower" for valuing inventories, a general principle for which accountants had been contending for years.

Cost or market, whichever lower

When Colonel Montgomery published the first edition of his *Auditing Theory and Practice* in 1912, it included a clear statement of the principle of valuing inventories at cost or market, whichever is lower, and gave the reasons therefor. We were at that time still in the period when it was not unusual for business men to argue with accountants that, if it was sound to write down inventories if market prices had fallen, they ought to be written up if market prices had risen since the goods had been acquired.

The earliest Treasury regulations made no provision for recognizing a reduction of inventory from cost to market where there had been a fall in market prices. The form of income tax return prescribed for corporations, as late as the October, 1916 issue, directed that

> In case the annual gain or loss is determined by inventory, merchandise must be inventoried at the cost price, as any loss in salable value will ultimately be reflected in the sales during the year when the goods are disposed of.

However, Treasury Decision 2609, promulgated December 19, 1917, recognized the propriety of using the basis of cost or market, whichever is lower.

Bank credit practice received a considerable impetus toward development and improvement with the organization of the Robert Morris Associates in 1915. The members of this organization are credit executives of banks and other credit granting institutions. This organization recognized the soundness and desirability of the cost or market, whichever is lower, principle and gave active support to the efforts of the accountants to secure its general acceptance in businesses in which inventories were a factor in determining financial position and earnings.

Philosophy of the rule

Accountants have always recognized that the cost or market, whichever is lower, rule is not based on logic, but is a counsel of conservatism. It is the outgrowth of experience on the part of business men and the observation of the pioneers among public accountants who saw the need for some such principle for the preparation of dependable financial statements.

Basically, an inventory is to be taken at cost because it represents expenditures made for the purchase of goods of which a future fiscal period will have the benefit, since they have not yet been used and, consequently, that much of past expenditures should be carried forward as a charge to future operations. Even though the apparent market value (on a replacement cost basis) may have increased, because of a rise in quoted prices, the inventory should not be valued above cost, because to do so would give the past period a credit for an apparent profit which will not be realized until the goods have been disposed of in the future period. The old adage, "don't count your chickens until they're hatched," is a sound one in respect of appreciation in inventory value, as well as in the case of other assets.

On the other hand, the same counsel of conservatism calls for provision for, or recognition of, the potential loss in the case of a current asset like inventories. Especially in the case of an asset which has a relatively quick turnover, potential losses are much more likely to be sustained than apparent appre-

ciation be realized. This seems to be one of the perversities of fate which is continually bothering the business man.

What is "cost"?

This sounds like an easy question, especially in respect of goods which are resold in the same form in which purchased or in the case of raw materials purchased for use by a manufacturing concern. In practice, however, it is found to be anything but an easy question to answer in determining the cost of a given inventory. There are various reasons for this.

One is the continuous nature of a business concern; the year, particularly in non-seasonal enterprises, does not represent a business cycle, but is an arbitrary (even though customary) interval of twelve months at which to state the results of operations and the financial position of the concern. The intermingling of goods purchased at different times and at different prices, resulting in the impracticability of attempting to identify the particular goods sold or used with their original acquisition is another complicating factor.

The changing price level which is never entirely stationary, and which, at times, is subject to violent fluctuations, introduces still another complication. If a business is to be continued and not liquidated, there is need for carrying a stock of goods and replacing it periodically, regardless of whether or not prices may be rising.

Still another problem arises from the fact that in some industries various products, or different qualities of goods, are produced from the same material or in the same operation, as, for example, in the case of lumber, anthracite, oil and tobacco. In the case of finished goods, as well as goods in process, the distribution of manufacturing overhead adds still another complication because it can obviously not be applied on any exact basis but must have in it a considerable element of assumption and judgment.

Following are a number of alternative methods of applying costs to sales, and consequently also the basis of costing the inventories at the end of the year:

1. *Specific costs:* practicable for very few businesses of any size; the business of a diamond merchant would be one in which it could readily be used;
2. *Average cost:* usable especially in industries having a comparatively small number of different materials or products, as in a blast furnace or a cement manufacturing plant;
3. *Base stock:* a stated quantity of material or product is regarded as a continuing necessity for the business, and is priced at a conservatively low price which is maintained unchanged from period to period; only any excess of stock over the fixed quantity is priced at current costs; copper and some other nonferrous metal industries

have been among the principal users of this method;

4. *First-in, first-out:* assumes that, when goods are so intermingled that they cannot be identified with specific invoices, those first purchased or produced are first used or sold, regardless of whether or not this be the physical fact; this is the method which is probably in most general use;
5. *Last-in, first-out:* assumes that (in case of intermingling as in 4) the goods used or sold are those which were most recently purchased or produced;
6. *Standard costs:* an estimated and predetermined cost, based upon specifications for material and direct labor, and an overhead allowance not in excess of that appropriate to a normal level of operating capacity; however, in determining material costs under this method a selection must be made from the several methods above described;
7. *Retail method:* used by department stores and many other retailers; inventories are determined, departmentally, by taking that percentage of the inventory at retail prices which (a) the opening inventory (less deduction for mark-on) plus cost of goods purchased during the period, bears to (b) the opening inventory (at retail) plus purchases for the period as priced at retail, including mark-ups.

Last-in, first-out

The tremendous rise in prices during the World War, with the collapse of prices of commodities and manufactures in 1920, and the rise of prices during the boom of the twenties, with the cataclysmic fall in prices during the early years of the depression, formed two completed price-level or inventory-price cycles. The effect of using the first-in, first-out method of costing sales and inventories was to exaggerate profits (peaks) and losses (valleys) of those businesses which need to carry large stocks of goods. During the period of rising prices, when lower cost inventory is being disposed of and replaced by higher cost goods, large and increasing profits are shown but at the same time the price level of inventories is mounting. The result is that, when the inevitable return of prices to a lower level of prices occurs, a substantial portion of the profits previously shown disappears because of the large write-down needed to bring the inventories to the current price level.

The base stock method of valuing inventories is commended by its advocates as a remedy for this situation, and the experience of a number of companies which use it, notably the National Lead Company, indicates that this is so. However, the rather arbitrary nature of this method, the fact that its practical application seems limited to a relatively small number of industries, and the refusal of the income tax authorities to accept it as a basis for computing taxable income, have tended to impede its acceptance by industrial concerns generally.

The last-in, first-out method has

received much consideration in recent years as one which would tend to obviate exaggeration of operating profits and losses, and to minimize, if not entirely avoid, inventory write-downs in periods of declining prices. In 1933 the writer addressed two chapters of the National Association of Cost Accountants on The Adjustment of the Balance Sheet to Present-Day Business Conditions. Attention was directed to the last-in, first-out method as one which would result in a truer picture of actual profit, and to the logic underlying it of a closer relation between the prices of goods last purchased and of the goods currently sold than between the prices of the earliest purchases of goods on hand and of the goods currently sold.

At the request of the American Petroleum Institute, the American Institute of Accountants appointed a special committee (on which the writer served for a time) to cooperate in a study of the inventory methods of the oil industry. The American Institute of Accountants Committee made a report (published in the August, 1936, *Journal of Accountancy*) expressing approval of the last-in, first-out method in appropriate circumstances. Many of the large oil companies have since adopted this method.

The 1938 Revenue Act gave recognition to the last-in, first-out method for use in determining taxable income of certain industries. This recognition of the principle is encouraging, but the present provisions are too narrow to be satisfactory. The Taxation Committee of the American Institute of Accountants has prepared a memorandum for the Treasury, urging a broadening of the provisions so that they may be more effectively applied and be used in any industry where the principle is applicable. The committee's memorandum was published in the November, 1938, issue of the *Journal of Accountancy* and is an excellent presentation of the matter.

Other phases of inventory valuation

Some other phases of this subject might well be touched upon, as, for example, elimination of intercompany profit and the problem arising when there are minority interests in the producing subsidiaries; is "market" the price at which goods similar to those on hand could be purchased or produced currently, or is it sufficient to reduce inventories of finished goods to prices at which they could be sold, allowance being made for selling expenses; and the question of whether there is not a better method of dealing with inventory write-downs in the income account than that generally used at the present time. However, this article has already passed the limits set for it, and these phases of the subject will have to be left for future consideration.

NEW YORK, N. Y.

Accounting Aid to Industry

By William F. Marsh

It has been said that no business enterprise can endure under existing competitive conditions unless it is underpinned with reliable accounts and costs.

It is equally true today that for a business enterprise to realize a reasonable profit with a maximum of stability, its management must be supplied with facts and information as a guide to the prediction of future trends. Increasingly, management is becoming convinced of the importance of modern industrial accounting.

As a consequence, the accountant has become a vital part of management. Instead of merely supplying, as a routine matter, reports and information which practice and growth have established, the progressive accountant must have the ability to winnow from the wealth of information at his disposal the particular facts and information most essential currently to management. As an illustration, the chief executive of a large corporation recently told me that, for a period of several months when relations throughout the country between business and labor were so acute, at least eighty per cent. of the reports furnished him by his accounting department consisted of pay rolls, wage rates and related data concerning labor as it affected his company.

According to available information the effect of the current business recession has been mitigated by the fact that, by and large, inventories are not abnormally high. In part, that condition may be the result of the relatively recent experience of 1929-1930, but a more logical explanation is the emphasis placed in recent years by the accountant on ways and means of controlling inventories.

Legislation, such as the National Industrial Recovery Act, the Social Security Act and the Robinson-Patman Act, has had a very definite effect on industrial accounting. Another important factor has been the growth in importance of the trade association. Scores of additional industries have adopted uniform accounting and cost systems and many have been modernized and revised.

The necessity for establishing adequate controls, providing worthwhile incentives and looking forward to probable trends has had the very natural result of focusing the attention of management on the advantages derived from standard costs and budgetary control.

The use of standards in one way or another is continually increasing. A correct measure of accomplishment can be made only by comparison with a standard or expected level of performance. Decisions based

upon comparisons with past performance are not conclusive because conditions are rarely identical. Only as we establish definite goals of achievement and set specific standards of accomplishment based upon current conditions do we get the best results.

Manufacturing cost standards based upon standard allowances for materials, direct labor and expenses are now widely used by well managed and successful manufacturing companies. The principal advantage, of course, is that management's attention is thereby directed to the variations of actual performance from predetermined standards, and any variance from the standard is stopped before it becomes dangerous.

In industry, the extensive use of the budget is a post-war development. It provides a means of financial and administrative control; hence, the use of budgeting by industry has been constantly increasing. It seems to me that management should use a budget, not primarily as a system of control, but as a plan which can and should enable it to realize a definite objective. Although a budget is in itself not a control, it provides a means of action by management which is control. It should be emphasized, however, that the budgeted operations should be not only possible but probable. In other words, the budget loses in effectiveness if the aim is unattainable. To be most fully effective, a budget should cover all phases of operation.

In its fundamentals, a budget plan in an industrial enterprise consists of three divisions: (1) assembling facts and information that may affect the operations of the business in a given subsequent period; (2) using the information so assembled to formulate a program or forecast of operating results; and (3) using the program as a measure or control of current operations.

Experience has proven that budgeting is ineffective without proper organization, adequate accounts, prompt comparison of actual results with the forecast, and institution of such necessary action as is dictated by the comparisons. These basic factors are interlocking. Unless corporate lines of authority are definite, denial of responsibility will prevent proper functioning of the budgetary control plan. However carefully prepared a budget may be, if the accounts are not designed to implement it, intelligent comparisons cannot be made of actual results with the forecast. Hence, before attempting to formulate a plan of budgetary control, it is essential that consideration be given to possible need for revision of the accounting and cost system. It should be remembered that standard costing supports a plan of budgeting and ought to be considered part of it.

The methods of showing differences or variances between budgeted and actual results naturally vary

with differing businesses. Practically all variances reflect the composite effect of at least two factors, rate and volume. Sales variances may be caused by changes in selling price or changes in quantities sold, or both; direct labor variances may be the result of changes in wage rates or time taken on the job; materials may vary in prices paid or in quantities used. It is also necessary to consider whether variances in expenses per unit are the result of the rigidity of fixed expenses or changed unit rates of variable expenditures.

The extent to which the cause for variances is presented or explained is largely a matter for individual consideration. The main point to keep in mind is that by these comparisons the accountant can inform management where its accomplishment is out of line with the expected level of performance, and why. Comparisons of actual results with forecasts are of limited value unless the program provides for determining the causes of all substantial variations and fixing the responsibility. Revisions may be necessary, either in performance or in the forecast, or perhaps in both.

Addressing the annual convention of the National Association of Cost Accountants, Mr. Walter F. Titus, Vice President of International Business Machines Corporation, estimated that the cost of distribution of manufactured products in the United States for 1935 exceeded six billion dollars, and expressed the opinion that distribution cost study offered the accountants a fertile field of endeavor. Production and control of distribution costs have, of course, been among the dominant subjects of discussion by industrial and professional accountants for several years. Frequently, the effort to increase sales volume occasions disproportionate increases in the cost of getting business, and consequently defeats its own purpose. For this reason it is imperative that effective control be exercised over the expenditures for selling and distributing so as to prevent them from getting out of line with the sales. The budget has been found to be an effective means of establishing control and substantial savings have resulted.

The budget, of course, has its limitations. Forecasting is not and never can be an exact science; even the best estimates are fallible. Judgment and common sense must be used in following any plan based upon estimates, and budgetary practice is no exception. One need look no further than the past decade to visualize the difficulty of forecasting sales during periods of either expansion or recession in general business. Whether one tackles the sales forecast by market analysis or by past performance translated into terms of future expectations, the results are likely to vary from the predetermined amounts. Difficulty of solution unfortunately does not dissolve the need. By careful consider-

ation of all pertinent information obtainable (both from within and without the business), and by subsequent alertness to detect factors requiring changes in the estimates, a satisfactory solution can generally be reached.

Probably the most important benefit to be derived from the operation of a properly coordinated budget and standard cost plan is the decided change in the attitude of the entire business organization which is likely to occur. Such a plan compels the operating heads of a business to look ahead and to establish the policies best calculated to result in the realization of the maximum net profit.

Management to progress must anticipate the problems it will be called upon to overcome. In the past, many business executives relied primarily on historical statements of what had been done. Today management realizes the importance of determining the probable trend of the business so that proper preparation may be made to meet conditions as they develop.

PITTSBURGH, PA.

Accounting Aspects of the Automobile Industry

(*Continued from page 11*)

tion, they have achieved inventory turnover beyond the dreams of manufacturers of many other products. Under normal conditions the manufacturers have little or no inventory of finished cars, the usual practice being to "drive away" or ship directly from the assembly lines. The published financial statements of several automotive manufacturers disclose an over-all inventory turnover of 10; in other words, the inventories are, in the average experience of these companies, moved through production and sold in approximately five weeks.

DETROIT, MICH.

Department Store Accounts

By Hermon F. Bell

Discriminating judgment that differentiates between the more permanent and the merely transitory is always difficult. What are relatively minor problems or changes in the broad course of business development may, from where we are at the moment, loom large. On the other hand, the true significance of today's questions and decisions may sometimes be fully understood only when later viewed in retrospect.

It is therefore not easy to sketch even in outline recent developments and present problems of retail merchants in true perspective or with the appropriate lights and shadows. Besides, progress is not even, either as between merchants or as respects the various problems that a single business faces. A store may long have been in the advance line as respects certain procedures, and behind in others.

The last fifteen years opened for department stores with a period of prosperity. There were years of great prosperity. Then followed periods which also showed good results but when increasing volume was more and more difficult to obtain and expenses were gradually mounting. Although the years were prosperous, very prosperous as measured by present standards, and the popular phrase "profitless prosperity" was a misnomer, that phrase yet came to be more and more appropriately descriptive of the trend.

Then came periods of falling volume, when expenses, as gauged for large sales totals, became less and less possible to carry, and then entirely out of line, not only when expressed in percentages but in aggregate amounts. The year 1932 was the period when outgo most exceeded income. Expense reductions, already made in some measure, now became an absolute necessity if business was to survive. As expense curtailments began to be effective and especially as sales ceased to drop but began again to mount, slowly at first and then somewhat more rapidly, operations began again to show net profits instead of losses.

About three years ago expense increases, both those that were admittedly unavoidable and those (such as pay roll) which were more or less voluntary and yet necessary and just, began to present new problems. In these years expense increases, contrary to the usual cycle, have come before or at best coincident with increases of gross volume, out of the gross margin from which they were to be met. Such increased expenses stood as a hazard if volume increases did not materialize. And as for any increases in net prof-

its (after a long period of poor profits or in many cases losses), it seemed clear that they must come if at all from better merchandising or from more efficient operating plans and controls. Besides, long deferred improvements to premises, fixtures and equipment, called for considerable expenditures out of profits just at a time when a tax was placed upon retention of profits for such a purpose. And recently increases of volume have been checked or reversed, at least temporarily, and many uncertainties abound. It is at the moment peculiarly difficult to attempt to look far ahead or to plan in a long range way.

The hope of department stores lies in the quality of their managements. These managements have been tested and tried as never before and their ability, resourcefulness, and integrity are in the last analysis the prime ground for confidence. The very difficulties that department store managements have had to meet, and have met, in recent years, may well prove to be the bases for success in the years just ahead.

Department store accounts have many subsidiary uses, but their main purpose is that of guidance and help to managements. In general, problems of department stores are similar to those of retailers operating under other forms, such as chain stores, mail order business, specialty stores, but there are differentiations in specific phases.

With the foregoing background, there are hereinafter listed, which is all that space permits, a number of the more significant recent developments or present facts as to department store accounts.

1. There is more widespread use of the retail inventory method than ever before, and particularly greater emphasis placed upon the help it can bring to the superlatively important task of controlling and improving gross margins, largely through the minimizing of mark-down and shrinkage losses.

2. There is more selective merchandising, that is, definite selection of price lines to be carried, and attention to the relative profitability of competitive lines, including choices as between branded and non-branded lines, as well as increased promotion of reasonable profit merchandise, and elimination of mere volume feeders or loss leaders.

3. There is renewed emphasis upon control over receipt, marking and storage of merchandise, as well as upon systems of control over sale and delivery of merchandise,—in short, emphasis upon better control of merchandise in and out, which increases the efficiency of the retail method.

4. There is growing consensus of opinion that inventory values as computed under the retail method need to be further reduced by provision for mark-downs accrued as it were but not yet taken at the balance sheet date.

5. There is increasing emphasis

upon, and use of, detailed plans for future operations, by short periods such as weeks or months, including planning of sales, purchases, markdowns, shrinkages, and stocks for each selling department, also budgeting of expenses under the store's detailed control classifications.

6. There is increasing attention to plans as made and to securing performance by checking against plans.

7. There is greater discrimination in the breakdown of expenses departmentally or otherwise according to the sources from which they are controllable. The so-called contribution theory of expense reports is one phase or method of making such discrimination.

8. There is a tendency toward strict control over buyers and buying policies, accompanied, however, by greater mutual cooperation. The buyer is informed to a greater extent of his operating results and his intelligent carrying out of control plans is enlisted.

9. There is closer attention to the relation between costs and earning power of salespeople. Much still remains to be done in the important field of developing better contacts and closer cooperation between management and salespeople, so that the latter more directly represent management and correspondingly enhance their own prestige.

10. In a number of large cities several major stores have opened suburban or other branches. This is a development whose results and future can hardly be forecast at present. Is it a temporary expedient or a new and major development of retailing?

11. Both from the expense and the service viewpoints, considerable attention has been given to the alternatives of carrying on or of purchasing some services outside, such for example as delivery, light, heat and power; also to the question of when and to what extent workrooms should be maintained and operated. A related question is whether and, if so, which departments should be leased.

12. There is the problem of ever increasing taxes of all kinds, federal, state and local.

13. There is increasing use of standards or norms of performance as a test of results, such helpful reports for example as compiled by trade associations and schools of business.

14. Accounts are being kept to an increased extent upon a weekly basis.

15. There is increased accounting attention to control of fixtures and equipment, with classified records of these assets and depreciation thereof, as well as of losses on obsolescence or abandonment.

16. Expenses are being analyzed, charted and studied intensively in an earnest endeavor to make it possible to sell goods at a lower gross profit.

17. Organization charts heretofore commonly accepted as standard

are being reviewed and revised in order to promote greater directness in action and reductions in operating costs.

Retailing has always been and seems likely to continue highly competitive. But its competition varies both as to type and its source. There may be competition in price, in service, in prestige, in style preeminence, or in institutional appeal, or in several of these factors combined. Managements have to choose where they will place the emphasis.

The number of major department stores seems in most cities not to have increased. Yet merchandising competition is probably greater because from more varied sources. Also, there is important competition as to consumer spendings, whether, for example, income will be spent in travel or a new automobile rather than in clothing or in home furnishings.

At first glance and superficially it may seem that department store managements are beset by conflicting interests and almost insoluble problems. Certainly an impressive catalogue of difficulties could be compiled. Increased gross margin is needed without overcharging the consuming public. Expenses need to be reduced without taking it out on employees whose total compensation amounts ordinarily to one-half of all expenses. Capital needs to be conserved at a time when there is pressure for dividends (in some cases in arrears), and when retention of earnings may increase corporate taxes.

The way to sound solutions is believed to lie not in emphasis upon surface conflicts of interest but in recognition of the more fundamental harmonies. The interests of management and owners and employees, as well as of the purchasing public, are more in accord than at variance. In its leadership of an essentially cooperative purpose lies the field of management. It is there that its rewards are to be obtained. As a guide to sound appraisal and just treatment of the rights of the various interests involved, management has need as never before of accurate, up-to-the-minute accounting facts, as simple in form as possible, but pertinent to all the various questions that come before it for decision. It needs such facts not only for knowledge of past results, or present conditions, but perhaps most of all for its guidance in planning and in its carrying out of plans. Accounting procedures are developed for these purposes and are good in the measure in which they thus serve.

NEW YORK, N. Y.

Special Accounting Considerations in Cotton Merchants' Accounts

By J. F. Stuart Arthur

The significant and the peculiar phases of accounting calling for special consideration which arise from certain aspects of the cotton merchant's business were finally given recognition by the federal taxing authorities when the Bureau of Internal Revenue, in Appeals and Review Memorandum 135, acknowledged the right of dealers in cotton, to include in their accounts, for federal income tax purposes, the effect of such open "future" contracts to which they are parties, as are "hedges" against actual "spot" or cash transactions, provided that no purely speculative transactions in futures not offset by actual "spot" or cash transactions are included until actually closed by liquidation.

This acknowledgment coming, as it did in 1921, and somewhat belatedly, after vigorous representations by cotton merchants (and also by grain merchants on their own behalf for similar conditions) contributed to bringing the statutory taxable income of the taxpayers in question into a somewhat closer balance with actual income, and perhaps has been of assistance in causing not a few of the merchants interested to give a closer attention to accounting procedure relating to the extremely important effect of "hedging" and the proper evaluation of the "open position" with respect to future contracts at the close of a fiscal period.

The classification of a trial balance of accounts into balance sheet and profit and loss items, after the application of proper accruals and inventory valuations—often a matter of continuous record in ordinary commercial accounts—in the majority of businesses suffices to give prima facie information as to the status of the concern and the current income account. This is not the case when the financial records of a cotton merchant are considered, without the proper valuation of the effect of the "open position" items. It is only at certain rare times, perhaps at the close of a season, when there has been a complete liquidation of the inventory and when all contracts have been filled or closed out, that the financial records of a cotton merchant present complete results.

The most important elements of a cotton merchant's business, and the ones which very often are the cause of heavy loss or even of disaster, are not of record in dollar values until full consideration has been given to the value of all items in

what is termed the merchant's "position." Periodic trial balances of the accounts cannot in themselves be called significant, and the gross income and cost of sales, and outstanding claims by or against purchasers or vendors, are seldom a matter of complete financial record in the accounts at interim periods. Certain cotton merchants do prepare interim statements during the course of a cotton season, which generally is considered to end at the close of June or July in a given year, but very often such interim statements because of their incompleteness are of little value, and often are confusing if not entirely misleading. One has seen merchants, engaged in extensive operations, who had no accurate knowledge of the financial results of operations until the accounts were examined at the close of a season and the effect of the various elements of open position items were computed. That such a condition should exist in the attempt to ascertain the operating results or the financial position of a business where great skill is required for success, and where the methods are highly technical, is obviously unsatisfactory.

Perhaps the increasing intensity of competition and the need for operations to be conducted within a smaller degree of profit in this country will cause cotton merchants to recognize the value of more precise accounting methods.

In prewar years, and even for a number of years after that time, cotton merchants were dealing with cash transactions, in the main, and the accounting records and classification of accounts in use were considered reasonably satisfactory if simple in character. At the present time, the complexity of the merchant's business, combining as it does the functions of merchant, banker and broker, and involving the use of various methods, under the general term of "hedging," in attempting to limit risks from market fluctuations, demands an extensive and detailed system of accounts and of subsidiary records. In addition to the customary ledgers, journals, and cash records, detailed records of purchases and cotton received, sales and cotton shipped, and the outturn of such transactions, giving rise to claims pro and con, as well as complete and detailed stock or inventory records, records of open future contracts and foreign exchange transactions, are essential.

The future position record, sometimes termed the "position book" or the "long and short book," is used for the purpose of recording the merchant's commitments under contracts of purchase and sale of actual or "spot" cotton, presently or in the future, and his commitments in connection with "futures" or protective contracts executed through brokers, members of cotton exchanges organized for the clearance of such transactions. This record, which should be kept up to date at all times, shows

the daily transactions with respect to the purchase and sale of spot cotton, either at a fixed price or on call, and shows the daily transactions in futures. This is the cotton merchant's record which indicates to him his position in the cotton market both as to "market position" risks and as to "basis position" risks, and should be used as a check against the elements considered in the computation of the financial effect of the open position items.

In the ascertainment of a cotton merchant's financial position and the financial result of his operations, it is desirable that the valuations used with respect to the inventory of cotton and the elements of open position be placed on a liquidating basis, based on the published market quotations as of the date of financial statements. Due consideration must be given to the weight and to the grade and the staple classifications of the various bales of cotton ascertained to be in the inventory. Account must be taken of the location of the cotton, whether in the interior, at the port, in foreign warehouses or in domestic textile mill territory. The basic valuations with respect to cotton in the inventory should be obtained from the officially published quotations of the designated spot cotton markets, thus eliminating the effect of purely local conditions in the consideration of value.

A further refinement, as to inventory valuations, and one which for some years has been considered to be the really consistent and conservative method in the use of a liquidation basis of valuation, is to value the inventory, insofar as may be possible, by reference to delivery on a futures contract. This method of valuation will give a true liquidating value, with respect to cotton which falls within the classification of cotton tenderable on a futures contract. The advantage to be gained from the use of valuations based upon tenderable cotton, when proper consideration is given to the cost of carrying the cotton to the month of tender, and the costs of delivery at the nearest delivery point, is the definite allowance of valuations which use the published differences for grade and staple classifications in the officially designated spot cotton markets. Further, the normal functioning of the cotton market is such that the merchant can always dispose of his tenderable cotton against a futures contract. He has in his own hands the control of this matter and does not have to wait until his cotton is sold, lot by lot of particular character, to a variety of buyers, and subject to the usual delays and risks attendant on the usual exigencies of trade. If the merchant has the necessary open short futures, this method of valuation is equivalent to the closing of his position in respect of such futures and the relative tenderable cotton. If the merchant does not have such short futures in his position, they may be contracted for at once.

Such cotton as may be in the inventory, which is not of tenderable classification, should be made to conform in respect of its valuation, with tender prices, with adequate adjustments for grade and staple differences and with sufficient discounts to cover the possibility of liquidation not being secured promptly.

In addition to the foregoing noted considerations with respect to inventory valuations, the cotton merchant must value, for balance sheet and income statement purposes, the effect of his obligations on open transactions. Without going into the intimate technique of these matters, it is sufficient to state that these valuations may be ascertained by effecting a theoretical close-out of all the open items at the balance sheet date, by application of the closing appropriate cotton market quotations at that date.

In the valuation of a cotton merchant's obligations on open transactions, the fluctuations of the futures market prices have been considered, but the question of "basis," that is, the relationship between the actual price of cotton and the price of futures contracts, has not yet been considered. This procedure is desirable because in the valuation on a liquidating basis, effect has been given to such items as are within the merchant's undisputed and immediate control. "Basis" risks are not of this character, but are part of the business risks which the merchant will have to meet at all times, and they are beyond his control.

The cotton merchant's accounts and the establishment of a balance sheet and a seasonal income account with any degree of accuracy, lend themselves peculiarly to the use of a fiscal year closing, coinciding with the close of the normal cotton season, as any other closing date will necessitate valuations of a position which is generally extended and complex.

A peculiarity of the acceptance by the Bureau of Internal Revenue of the cotton merchant's valuation of inventory at market prices and the evaluation of future contracts, is that the future contracts which may be termed to be speculative must be eliminated from consideration. It would be of great interest for one to be shown how, except in the simplest of cases, one is to identify the exact future contracts creating the long or the short position on the market, which may be termed speculative. And this acceptance of the theoretical balancing of the open position with respect to "longs" and "shorts" is without consideration of the possibility of an unbalanced position with respect to futures contracts in various months of delivery, and with respect to spot cotton sales commitments calling for classifications of cotton not covered by similar items in the inventory or under contracts of purchase.

DALLAS, TEX.

Influences on the Development of Investment Company Accounting

By Donald P. Perry

The development of investment companies (usually called "investment trusts") in this country has been primarily during the past ten years. During this brief period the application of accounting principles and improvements in financial reports by these organizations have been materially influenced from several directions.

While investment trusts have existed for many years in Great Britain it cannot be said that the form and methods of accounting used by those older organizations have greatly affected the accounts of American investment companies. The general aim of the British trusts has been for stability, particularly of income return on their securities, and it has been common practice with them to set aside capital gains as reserves or for the purpose of writing down book amounts of their investment portfolios.

Perhaps because the short period of existence of most of the American trusts has been characterized by violent fluctuations in the security markets and because of the effect of the credits for dividend payments provided by the Revenue Acts of 1936 and 1938, they have had little opportunity to build up reserves out of profits. Investment reserves and write-downs have been made by them chiefly out of capital reductions or appropriations from capital surplus, and for the purpose of eliminating deficits rather than of stabilizing return on capital.

Whatever the purposes of the managements, investors in the American organizations have kept their eyes fixed largely on changes in the market and liquidating values of the securities. Thus the nineteen-thirties have seen generally greater expansion of the American open-end investment companies with one class of stock which the companies sell to investors (or repurchase) at prices based upon the daily quotations of the underlying securities in their portfolios. Also, whenever their reports are issued, the break-up value of companies with fixed capitalization is watched closely by analysts.

This interest in liquidating or net asset values is reflected in the form of financial statements now issued by the American companies. It has been their general practice from the first to disclose the market value of the portfolio in conjunction with the balance sheet. Now it is almost invariable that the operating state-

ment is supplemented to show the gains and losses realized plus the change in unrealized appreciation or depreciation of the portfolio securities.

A number of investment companies, and not only those operating on the open-end plan, have changed their basis of presenting financial statements from stating securities at cost (with parenthetic notation of market values) to stating them at market values at the end of each period. As the security markets rise and fall, therefore, reported financial condition and operating statements of these investment companies fluctuate widely and reflect the changes in the break-up values of their equity securities.

Even prior to the market collapse of 1929, accountants, blue sky commissions and the stock exchanges recognized the peculiar fiduciary nature of the newly formed investment companies and the potential dangers of losses to investors from manipulation and mismanagement, if the financial facts about them were not fully and freely disclosed. The influence of all of them has been exerted in favor of the publication of all essential facts in financial statements and the scope of information reported has been steadily amplified.

This tendency to report in considerable detail on many financial factors again runs generally counter to the British tradition. In September, 1936, *The Economist* (London) stated "The essential feature of investment trust practice is that directors ask for, and receive, the equivalent, within wide limits, of a blank check from investors. In the long run, the real *security* for investment trust stockholders is the experience, acumen and good faith of the men in control."

While the latter statement is true in all events, it cannot be said that the investors in American investment trusts are giving the managements blank checks for any long periods of time. Not only do the American trusts report periodically lists of portfolio securities and the interim changes therein, but the financial statements have generally been expanded to provide more and more details and are frequently supplemented with miscellaneous information about transactions and operations which in earlier days would not have been disclosed to others than the management.

The New York Stock Exchange recognized that the financial community had a possible problem in connection with this rapidly growing investment medium. After careful study, the Listing Committee of the Exchange in 1929 promulgated a set of special requirements for listing investment trust securities. The accounting requirements were intelligent and reasonable as to the form and extent of information to be reported and were generally adopted by managements and their auditors as a standard for investment com-

panies whether listed or not. Further improvements in practice and amplification of information have developed in the subsequent years from this generally accepted standard.

The Blue Sky laws and their administration in the various states have imposed varying regulations which have resulted in a great diversity of forms of financial statements submitted to state agencies. Finally, the requirements of the Securities and Exchange Commission, operating under the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935, have resulted in material amplifications of the amount of detailed information publicly reported by investment companies.

The Securities and Exchange Commission not only has jurisdiction over the reports of listed companies and of companies issuing new securities, but the Public Utility Holding Company Act of 1935 also required the Commission to make an exhaustive study of the functions and activities of investment companies and to report to Congress the results and recommendations. While its final and complete report of recommendations has not yet been presented, its investigations through questionnaires and hearings have undoubtedly had their effect on accounting by the companies.

As a result of all these influences we find investment company reports classifying the sources of income and the expenses in greater detail, segregating earned surplus from paid-in and other capital surplus, and indicating the sources from which dividends have been paid. Increasing recognition that gains or losses from sales of portfolio securities are not of the nature of ordinary recurring income has led a larger number of companies to segregate these items and carry them direct to earned surplus or special surplus accounts. Gains from transactions in the company's own stocks are segregated from ordinary operations and not carried to earned surplus. If any stock dividends are taken up as income, attention is called to the fact with full explanation of the basis of accounting used. It is now customary also to state the basis of determining gain or loss when there is sold a portion of the holdings of a given security which had been acquired at different dates and prices —whether the cost of the portion sold is computed (1) at the average cost of the whole block, or (2) on the assumption that the portion sold was from the units first acquired, or (3) on the basis of identifying specific securities with their specific costs.

Finally it must be recognized that federal and state tax laws have had an active, if indirect, influence on the accounts of these organizations. Taxes on capital gains have been a

major factor in both federal and state taxation and this type of tax has presented a number of problems in the accounting for investment companies. In many cases this portion of the taxes is deducted from the realized gains reported in financial statements. Where unrealized appreciation and the change in unrealized appreciation during a period have been reported, it is recognized that there should be deducted in each case the potential tax which would result if the appreciation were realized. Such provisions for potential taxes are of course not appropriate in the case of a company which qualifies as a "Mutual Investment Company" under the provisions of the recent federal revenue acts mentioned below.

Furthermore, information about the costs for tax purposes of all securities must be kept up to date in the records, because such costs may differ substantially from the book costs used for general accounting purposes. Many companies have adopted the federal tax basis of computing costs of securities sold for their general accounting, although differences between state and federal bases and changes in tax regulations have detracted from any advantages found in this method.

The Revenue Acts of 1936 and 1938 contain a provision of great importance to investment companies. Companies qualifying as "Mutual Investment Companies" under specific definitions in the Act are thereby entitled to deduct the amount of dividends paid by them as a credit against net income for the purpose of computing the normal federal tax as well as the surtax on undistributed profits under the Revenue Act of 1936 and such tax as may be payable at the special rate of 16½% under the 1938 Act. This credit is based on the principle that the open-end trusts were primarily media for joint investment of many individual funds and that, if they distributed practically all their income so that the shareholders would be taxed individually thereon, it was only fair that the companies be relieved of taxes on that portion distributed.

The definition of a "Mutual Investment Company" is restrictive and not only requires that 90% of net income (including net gains on sales of securities) should be distributed to the shareholders within the year as taxable dividends, but also places limitations on the investments and the operating methods of companies desiring to qualify, so that it has been necessary to watch constantly all the factors of compliance with the definition in the law.

Records, particularly on the tax basis, must be maintained with especial care and watched constantly, inasmuch as an error may throw the corporation out of the "Mutual" category and impose on it a large tax in addition to what the stockholders pay as individuals. Naturally the

(*Concluded on page 75*)

Cooperation between Bankers and Accountants

By Joseph M. Pugh

The development of cooperation between bankers and public accountants during the existence of our firm has been most interesting to watch. In the early days of our practice many engagements were for the purpose of furnishing credit information to bankers regarding their borrowers. It gradually grew to be the custom for bankers to ask borrowers for financial statements prepared by independent accountants, and borrowers who had previously had no contact with our profession were made cognizant of the advantages gained by supervision of their accounting records and systems by public accountants. From examinations for credit purposes many engagements for the installation of accounting systems developed. The writer sometimes wonders if the accounting profession as a whole realizes and appreciates the great extent to which commercial and investment bankers have contributed to the practice of the profession.

Bankers had confidence in our ability to state clearly the financial condition of their borrowers, and the next natural step was that we should be engaged by bankers to examine their own accounts and to make special investigations and revise their accounting systems. It is believed that the first regular examination made in the United States of the assets and accounts of a bank by public accountants was that made for the Board of Directors of the old Bank of North America in Philadelphia in 1891 by Heins, Whelen, Lybrand & Company, later Heins, Lybrand & Company, of which firm the founders of our firm were partners.*

These examinations were continued periodically by our firm from 1906 until the merger of the Bank with The Pennsylvania Company for Insurances on Lives and Granting Annuities in 1929.

Examinations of banks in earlier years were made in the greatest secrecy, it being feared that if the depositors were aware of the examination, they would be afraid something was wrong with the bank. The accountants had to enter and leave the bank by side or back entrances

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* The Bank of North America was the oldest bank in the Western Hemisphere. Robert Morris, the financier of the Revolution, was responsible for its founding in 1781, two years before the treaty of peace was signed between England and the thirteen colonies.

and during business hours had to remain discreetly behind the scenes where they would not be seen by the depositors. Postings to the depositors' ledgers were verified in detail from the check and deposit scratchers, which were chronological records of all checks paid and deposits received. The verification of footings in the scratchers and depositors' ledgers afforded much experience to the partners and staff in that form of mental exercise. We were not permitted at that time to communicate with borrowers or depositors to obtain direct confirmation of the correctness of the accounts as shown by the bank's records, excepting in unusual instances.

The type of examination referred to above has become obsolete, due to the public having become educated to the services rendered by public accountants and also to the evolution of bank bookkeeping from hand posted ledgers to machine posted ledgers and the development of methods of internal check and control. The requesting of confirmation of the correctness of the balances as shown by the records of the bank by correspondence with depositors and borrowers is now generally considered to be a necessary part of an examination.

It is uncommon today, even in the rural sections, to find a bank without mechanical equipment. Today instead of leaving a pass book for balancing at the bank at irregular periods, the use of bookkeeping machines has made it feasible for statements of depositors' accounts to be mailed to them at regular intervals. Photography has been developed to such an extent that many banks now photograph each check handled; prior to this improvement it was sometimes impossible to trace checks of even amounts, because of the number of checks of the same amount. Now, when the necessity arises, the photographic film is projected on a screen and duplicates of checks made. The latest photographic device for bankers is an automatic teller in which the depositor places deposits comprised solely of checks and a photographic film of all checks and deposit tickets is automatically made to provide a permanent record.

Accountants were called upon during the banking crisis of the depression to make examinations for clearing house associations for the purpose of determining the solvency of banks which were suffering from heavy withdrawals of deposits, and to assist in formulating methods of assisting such institutions as were deemed worthy in order to avert if possible the closing of the bank. Time being of the essence in such cases, all-night sessions were fairly common and on one occasion one of the members of our firm had a Christmas breakfast of ham and eggs in a Childs' restaurant, after spending all the preceding night reviewing report schedules, and then telephoned his wife to wish her the

compliments of the season. However, the fact that in some instances our labors played a small part in avoiding the distress which would have followed the closing of the bank made us feel that we were doing some service to mankind.

During the crisis the accountants had the unusual experience of seeing clients also keeping late hours, as the members of the clearing house committees were somewhat akin to a fire brigade—twenty-four hours a day on the job. Some conferences lasted almost until daybreak and others started as early as seven in the morning. Instead of the bankers being hardboiled and exacting a pound of flesh for assisting their troubled brethren, they were human and often one of the first considerations was the number of depositors affected.

After the memorable bank holiday of 1933, when many banks were closed never to reopen, such problems arose as working on plans for possible reorganizations, acting as receivers, and determining contingent liabilities arising from trust department matters. Communities were crippled because of the stoppage or curtailment of local banking facilities, and business leaders organized committees whose object was to facilitate the reopening of closed banks in order to release part of the deposits. Accountants were called upon to prepare statements and plans of reorganization for presentation to supervisory authorities in order to enable them to pass upon the feasibility of the plans. In one such instance, the local Real Estate Board volunteered its services and all its members joined in making appraisals of all real estate in which the bank was interested.

Supervisory authorities, in considering whether a reorganization plan was workable as regards the assets of the banking departments of closed banks, were sometimes handicapped by lack of sufficient examiners to investigate promptly the trust departments of the banks. Accountants were retained in some instances to conduct investigations of the trust departments to ascertain whether or not contingent liabilities existed which might affect the reorganization plans.

As previously commented upon, during the financial crisis the element of time was the essential feature of many of our banking engagements and at times completion of the work we had undertaken, within the time limit, appeared to be an impossible feat. It is a source of gratitude and pleasure to pay a tribute to the members of our organization who by their cooperation and esprit de corps made possible the satisfactory culmination of engagements, which not only enhanced the reputation of the firm but were of value to the community at large.

PHILADELPHIA, PA.

Some Features of Life Insurance Company Accounts and Statements

By A. Karl Fischer

The accounts of life insurance companies are almost entirely on a "cash basis" and, though all companies follow a system of accounting whereunder the debit balances equal the credit balances in the general ledger, the systems are little more than single entry in that some of the assets and almost all the liabilities which must be set forth to present a balance sheet and an income account are not recorded upon the general ledger. In the required "annual statements," however, the insurance companies carefully set forth all assets and liabilities and their income accounts.

"Annual statements" as at December 31st of each year, containing not only the balance sheet and income account but a great deal of other detailed information, must be filed with the insurance department of each state in which the company is licensed to operate. A uniform blank for filing has been adopted by all states of the Union, although some states require information in addition to that called for by the uniform blank. The printed report furnished policy holders annually contains the balance sheet taken from the "annual statements" but somewhat condensed. It is often accompanied by some other statement such as an insurance account, a statement of receipts and disbursements, or a schedule of securities owned.

In any discussion of the items in the balance sheet there should be kept in mind the following general classifications that appear in the "annual statements": "non-ledger assets"; "ledger assets"; and the two classifications embracing both of the foregoing: "admitted assets" and "assets not admitted."

The non-ledger assets and the liabilities at December 31st of each year are to a large extent obtained by listings from the respective groups of individual cards and records. The more important items occurring under these categories are (1) interest and rents receivable due and accrued, and deferred and uncollected premiums, among the assets, and (2) premiums paid in advance, unearned dividends left to accumulate at interest, dividends declared for the ensuing year, expenses unpaid, accrued taxes, and death claims awaiting payment, among the liabilities. Of late years carefully obtained estimates as at December 31st have been substituted to some

extent for listings. In such cases listings are made every few years to make certain of the accuracy of the estimating methods. The estimating of interest accrued on mortgages has been found to work satisfactorily, as has the listing only occasionally of deferred premiums supplemented by estimates in years between such listings.

Accrued interest on bonds in default is not an admissible asset. It is interesting to note, on the other hand, that overdue rents and overdue interest on mortgages are admissible. Items overdue many months, however, should not be valued and reserves against overdue items are usually generous.

One other class of non-ledger asset which requires mention occurs in connection with ledger assets. Admitted ledger assets are included in the "annual statements" at their market or other prescribed valuations. In such "annual statements" they appear in two amounts: one, their ledger value, and the other, the excess of market or amortized value, etc., over book value (the non-ledger value). In the balance sheets furnished policyholders the entire market or other appropriate value of each class of asset is, however, for convenient reading often shown in one amount only.

The group of non-admitted assets includes assets which the insurance laws of the various states, or the practices of the insurance commissioners, do not permit to be included among the assets in arriving at surplus of the reporting company. They may comprise either ledger or non-ledger assets, such as assets which are not legal investments (advances to agents, prepaid expenses, furniture and fixtures, or supplies) and book values of admitted assets in excess of ledger values. These items, if on the books, are required for reconcilement of the "annual statements" therewith, but many companies give no recognition to non-admitted assets in their reports to policyholders. Except for advances to agents, many companies write off non-admitted assets as soon as the expenditures therefor are made; other companies, however, carry on the books such accounts as inventory of supplies, prepaid expenses, etc., for the purpose of keeping a better control over monthly costs of conducting business.

Among the admitted ledger assets, the items in regard to which practice is somewhat unusual are bonds and stocks, policy loans and real estate.

Insurance companies, when permitted by law, have been required by the Insurance Commissioners in the past to carry bonds, if amply secured and not in default, at amortized values instead of at either cost or quoted market values. All states now permit life insurance companies so to value their bonds. Stocks and bonds which under state laws, or because not amply secured or in

default, may not be carried at amortized values are required to be carried at "market values" prescribed by the National Convention of Insurance Commissioners; these are termed "convention values." It is to be noted that these values are not always market values at December 31st but values determined on various bases decided upon by the Convention. Some companies adjust ledger values of securities each year to amortized or other allowed or prescribed values; some do not.

An interesting point concerning policy loans is that, whereas the policyholder signs notes for cash advances, it is seldom the practice to have him sign a note for interest which is not paid and in consequence added to the principal. Under the contracts the additions of interest are as good a lien as the principal represented by the notes themselves. It is important to note that, with proper provision in the terms of the policy, the company need not hold the policy to have a first lien as against any uninformed persons who may also have made loans against the policy as collateral.

The condition of the real estate market and particularly the inability of many property owners to carry their mortgaged properties in the past few years has caused vexing problems to many financial institutions, but more especially to insurance companies which have the problem exaggerated because of having to contend with the laws and practices in the many states in which their mortgage investments have been made. One important point of difference between states is that there are varying periods during which, after foreclosure, the previous owner has the right to redeem the property. During this period the investment is neither fish nor fowl. It is the general practice to treat such items as mortgages until the end of the redemption period, when the company gets a clear title to the property. It is also rather generally the practice to charge to the cost of the investment the costs of foreclosure, taxes and fire insurance advanced by the company to the expiration of the redemption period. Some claim that interest accrued and unpaid prior to foreclosure should be included in the cost of property. If the cost thus determined exceeds the value of the property, the asset must be reduced to the appraised value in the "annual statements." There may be some academic justification for including uncollected interest in cost but it is believed that very few companies do so.

In many states there are statutory periods after the mortgage matures, at the expiration of which the lien becomes defective or entirely expires unless new papers or an extension are obtained or other steps taken. The company employees must be on the alert to avoid loss from this source.

A situation somewhat the reverse

of the foreclosed mortgage during the redemption period is the property sold by the company under a real estate contract. Such contracts take various forms in various states, but their general characteristics are that title remains with the seller until certain conditions of payment are met by the buyer. In some states, at least, even though the buyer does not fulfill his part of the contract, the seller cannot reestablish his undisputed title without certain legal action and this requirement makes the contract somewhat similar to a mortgage. The asset is not in the class of property represented by a clear title, neither is it wholly in the nature of a mortgage. The "annual statements" require a segregation of real estate sold under contract, but there is seldom a segregation in the balance sheet furnished policyholders.

An interesting problem is presented in regard to the indicated profit in the case of a property sold under a real estate contract for more than the book value of the property. There appear to be three conservative methods which may be followed: the most conservative recognizes no profit until after the entire book value has been recovered; the second method recognizes no profit until the book value reduced by credit of payments thereto equals the amount of a mortgage loan which the company would be willing to make on the property; the third method prorates each collection between (a) reduction of principal and (b) profit.

The collection of rentals on farms owned by accepting a share of the crop presents a troublesome practice. The problem of making a satisfactory contract in each case appears to be simple compared with that of collecting the company's just share. The company is dependent on the experience, ingenuity and the honesty of the representative who negotiates with the farmer. As for verifying income from such rents, the auditor must satisfy himself the best he can.

We hear that insurance companies are undertaking a new activity—the partial financing of building operations. This may cause some accounting problems. Commitments for investments in mortgages have in the past been relatively small and it has not been the practice to recognize liability in respect of such commitments as they were considered to be in the regular course of business of making investments. It would seem that an insurance company could not readily withdraw from a commitment on a building operation. Hence, if such commitments amount to aggregate figures of large size, they may require mention in published reports.

PHILADELPHIA, PA.

Some Changes in Stock Brokerage Business

By H. H. Dumbrille

Many changes have taken place in the stock brokerage business in the last forty years, not only in the method of conducting business, but also in the volume of trading, and the laws governing the trading in securities.

When I joined the staff of Lybrand, Ross Bros. & Montgomery early in the present century, the New York Curb Exchange conducted its business in the open on Broad Street, amid much shouting and noise. The representatives of the various firms wore hats or coats of distinctive color so as to be readily identified, and the business of trading was carried on by means of signs and gestures from the traders in the street to clerks in windows of nearby buildings facing on Broad Street. This method of doing business was followed for many years in all kinds of weather, until the New York Curb Exchange erected its modern building on Trinity Place.

The New York Stock Exchange always conducted its trading indoors and is now housed in a beautiful building at Broad and Wall Streets.

There have also been significant changes in the membership of the New York Stock Exchange. On January 1, 1900 there were 1,100 members and 521 member firms as compared with 1,375 members and 652 member firms on January 1, 1938. These figures include out-of-town members and member firms.

The volume of business of the various stock brokers has also been materially enlarged. Not only has the number of customers increased but a greater number of individual issues has been listed on the New York Stock Exchange and the number of shares and par value of bonds traded in daily has also greatly increased, as will be seen from the following statistics taken from the New York Stock Exchange Year Book of 1937:

The first day on which stock transactions totaled more than a million shares was December 15, 1886 (1,199,942 shares).

At the first of the year 1898 the individual issues listed comprised 390 stocks and 884 bonds, or a total of 1,274, while at the first of the year 1938 there were 1,259 stocks and 1,376 bonds, or a total of 2,635. The maximum issues listed as reported January 1, 1931, were 1,308 stocks and 1,607 bonds, or a total of 2,915.

The annual reported volume of trading on the New York Stock Exchange

for the year 1900 was 139,074,651 shares of stock and $577,763,080 par value of bonds. For the year 1929 the reported volume was 1,124,608,910 shares of stock and $2,996,398,000 par value of bonds. Some decline in volume of shares has taken place and for the year 1937 the reported volume was 409,464,570 shares of stock and for the same year a reported volume of bond sales amounting to $2,792,531,000 par value of bonds.

It is stated that on October 29, 1929, when total reported transactions amounted to more than 16,000,000 shares, approximately 15,000 miles of ticker tape was used on the stock tickers alone, while for the year 1929 tape used on stock tickers measured approximately 5,340,000,000 feet, or more than 1,000,000 miles.

On October 23, 1907, call money loaned as high as 125 per cent.

The highest price for membership was $625,000, paid in 1929.

The years have also brought significant changes in the procedure and requirements of the New York Stock Exchange, some of which are:

The establishment of the Stock Clearing Corporation for facilitating the delivery and receipt of securities listed on New York Stock Exchange and the settlement of balances (moneys and securities) with brokers, also for the clearance of loans for member firms. Under the present rule, which was effective September 1, 1938, all transactions in stocks listed on the New York Stock Exchange are cleared and settled semi-weekly. Apparently, however, this procedure has not facilitated the work of the member firms as anticipated, for as the result of a questionnaire sent by the Exchange to all registered firms to determine their preference, the old "skip-a-day" settlement plan is to be reestablished on December 1, 1938.

The issuance twice a year of a "Questionnaire" to member firms, response to which must be made by said member firms to show their financial condition. The Rules adopted by the Governing Committee of the New York Stock Exchange call for an audit of the books, which audit must be coincident with the preparation of the answer to the questionnaire. Regulations are prescribed for making such audits. It is optional with the member firm as to whether they delegate office employees or outside accountants to make the audit and prepare the response to the questionnaire, the only regulations being that the audit must be made in a manner acceptable to the Committee. The prepared response to the "Questionnaire" must be accompanied by a form of attestation signed by each partner of the member firm, and by the auditors.

Effective March 12, 1938, each registered firm of the New York Stock Exchange is required to make available for inspection by any of its customers, upon request, the information relative to its financial condition disclosed in the most recent answer to a financial questionnaire of the Exchange. On March 25, 1938, such registered firms were furnished with a prescribed form of condensed financial statement (statement of Assets, Liabilities and Net Worth) on which they might give or send financial information to their customers. Such statement indicates the net current assets or working capital as well as the net worth of the respective firm. This statement does not relieve the firm from the obligation to make available for inspection by any customer the financial information disclosed in the most recent answer to a financial questionnaire of the Exchange.

Many of the member firms engage certified public accountants to make the audits and prepare the responses to the questionnaires. A large number of these engagements has been handled by our firm.

The specification by the New York Stock Exchange of certain minimum margin requirements for the purchase and carrying of securities by its members for margin accounts. The stock broker may and very often does require higher margins.

Various measures for strengthening the regulation by the New York Stock Exchange of its members for the public benefit have been recently proposed, including (1) an increase in the number of periodic financial statements or questionnaires, (2) annual independent audits of firms doing a public business, (3) prohibiting margin transactions and maintenance of margin accounts by member firms and by partners of member firms doing a public business, (4) establishment of a 15 to 1 ratio between a broker's indebtedness and his working capital, and (5) establishment of a central securities depository.

Another vital development in the stock brokerage business was the enactment in 1934 of the Securities Exchange Act under which the Federal Reserve Board issued "Regulation T" effective October 1, 1934, the purpose of which was to prevent the excessive use of credit by members of a registered National Securities Exchange for the purchase or carrying of registered securities. Effective November 1, 1937, the Board of Governors of the Federal Reserve System amended Regulation T to increase the loan value from 45 per cent. to 60 per cent. of the market value of registered securities in customers' margin accounts. Regulations were also issued for the first time covering margin requirements on short sales.

A full discussion of Regulation T appeared in the November, 1934, issue of the L. R. B. & M. Journal, and a discussion of the amendment was published in the November, 1937, issue.

All stock brokers carrying blanket bonds issued by surety companies and designated as Standard Form 14 are required to have their accounts audited by a public accountant once during each year the policy is in force. Certain procedures are specified, such as mailing statements to customers showing money and security balances and requesting confirmations as to the correctness thereof, and if no reply is received within a reasonable time to forward a summary statement and a second request by registered mail with return receipt requested. In 1934 the surety companies added a new clause to the effect that in addition to the regular reconciliation of bank accounts as at the date of audit, a second reconciliation or "spot check" is to be made during the course of the audit, without prior notice to anyone in the employ of the insured. Some modifications have since been made and second requests to customers for confirmation of the correctness of their accounts may now be sent by ordinary mail and receipt obtained from the

post office (not from the customer) by payment of one cent additional per letter.

The system of accounts of stock brokers is different in many respects from the system of accounts usually found in a manufacturing or mercantile business. The books must account for both securities and cash. For example, the account for each customer records not only the money debits and credits but also the quantities and descriptions of the securities bought and sold. The balances of both securities and of money are ascertained and carried forward at the end of each month. In addition to the usual agreement of the aggregate of all money debit balances with the aggregate of the money credit balances of all accounts, the aggregate of the long positions of each security must agree with the aggregate of the contra positions (customarily designated as the short side of the security records) with respect to the same security. In other words, a perpetual inventory (for the most part the property of customers) is maintained with its location indicated.

The nature of the accounts is such that many of the items which require verification change materially with the resumption of each day's business. It is therefore important that certain work be completed the first day of the audit, such as the counting of securities on hand and the mailing of statements requesting confirmation of loans, collateral deposited, open transactions with other "Street" houses, and all other items which require immediate verification in order that they may reach those to whom addressed before any subsequent transactions are recorded which would render it difficult to check the correctness of the open items shown by the statements. An examination of a large brokerage house requires a large staff of assistants who must very often work until a late hour in order to complete certain phases of the examination before the books are required by the client for the next day's business.

With the sudden increases in the volume of transactions which sometimes occur almost over night (this happened in an exaggerated way in 1929) the personnel in a stock broker's office must at times work far into the night to complete recording the day's business, get out the notices of purchases and sales to customers, prepare the clearing house sheets, calculate the margins, etc. We have been called upon on many occasions to supply men to assist with this work and also to check over the recorded transactions, to locate errors, and to balance the security positions.

New York, N. Y.

Currency Depreciation and Restrictions, and Other Problems of the Auditor in Present Day Continental Europe

By Francis J. H. O'Dea

Presumably the above title will not convey to any reader the idea that currency manipulation is something new—a product of our modern civilization. Beggar-my-neighbor was a favorite game in the Treasuries long ago. Demetrius of Phaleros, writing in the fourth century B. C., complained that prices had quintupled since the time of Solon; and Roman emperors regularly depreciated their currency. More recently, a ruler of France (Philippe IV, le Bel, 1285-1314) earned the title of the "Forger King" (le roi faux monnayeur). And, lest we be accused of confining examples to continental Europe, let us complete a selection chosen at random by mentioning Henry VIII of England, in whose reign and in that of his son, Edward VI, records were established for the English course. To complete the parallel between our barbaric ancestors and our present high degree of civilization, it may be noted that a concomitant of currency manipulation in the past (in isolated cases) as in the present (in one case) was the decree of extreme penalties for the export of good money.

But, while we may not claim originality for our inflations, we can probably assert without fear of contradiction, that our modern inflations are bigger and better, and present deterioration in the value of money more rapid, than anything achieved by our less efficient forebears.

These fluctuations in the relative value of currencies, combined with the greater modern economic interdependence, create new problems for business and therefore for the auditor, and it is proposed to set out here a few of these.

Diversity of Currencies

Working in continental Europe, the auditor must at all times be prepared to deal with diversity of currencies. In times of comparative stability, this is a simple matter: a unit of one currency bears a certain relation to the units of other currencies, and accounts may be settled by a transfer of funds from one country to another.

At present, as the result of inflations, deflations, revalorizations of various kinds, and the restrictions imposed on transfer of funds, not

only is the relation between one currency and another subject to wide fluctuation, but we find that the currency of a single country may have a variety of values on the same date, the value in any one case depending upon, say, the nature of the debt to be satisfied, or the use to which the money is to be put. The best known example is probably the German* mark, where one finds a rate quoted for so-called "free Reichsmarks," another rate for Register Marks and other rates for various kinds of Sperrmarks, some of the last named being dealt in at a rate showing as much as 85% discount from the quotation for the "free Reichsmarks."

Transfer Restrictions

In cases where manipulation of the currency is accompanied by restrictions on the transfer of funds, additional questions are raised, and accepted principles of accounting must be adapted to the new conditions. Thus, receivables which formerly were regarded as short-term may have become long-term overnight.

Valuation Problems

In a country which has undergone a period of inflation, the valuation of assets purchased before, during and after inflation may present anomalies. For example, one German subsidiary of an American corporation may have acquired real estate before inflation for, say, the equivalent of $100,000; another German subsidiary may have purchased, during the inflation, equally valuable property for the equivalent of one tenth of that number of dollars. In a subsequent consolidated dollar balance sheet, these two properties of assumed equal worth would, on normal accounting principles, be included at widely varying values. One can go further: a third property of equal value with the other two, might have been acquired after the introduction of currency restriction in Germany, and after the devaluation of the dollar. Assuming that in German currency the price was equivalent to that paid for the first (pre-inflation) purchase, the cost in American dollars at the official exchange rates would be nearly double that of the first parcel bought.

Here is another aspect which is frequently encountered: an American concern has a subsidiary in a country which has devalued its currency. Before devaluation, the subsidiary borrowed an appreciable sum in dollars from the parent company, converted these to domestic currency and purchased a plant. The dollar loan has not been repaid when the domestic currency is devalued. The liability in terms of domestic currency is, immediately upon devaluation, inflated propor-

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* Mr. O'Dea's comments on German monetary practice are based on his first-hand observations, as he was in charge of our Berlin office from 1925 until we closed it in 1938.—*Editor.*

tionately to the drop in the value of the domestic currency as against the dollar, with a consequent exchange loss on the books of the subsidiary.

The plant, purchased with the proceeds of the dollar loan, remains in the accounts of the subsidiary at cost in domestic currency, at least at first. But devaluations in currency have usually, in continental Europe, been followed fairly rapidly by increases in costs, so that a time arrives when there is an argument for revaluing, in domestic currency, the plant acquired in pre-devaluation days. Tax legislation, in some countries, provides for this. If the only plant is that acquired with the dollar loan, the revaluation of the asset may more or less balance the revaluation of the liability. But, if there is other plant, acquired with funds obtained locally by the subsidiary, the situation is more complicated. The domestic liability has not increased in local currency; to revalue only the plant which has been acquired with the proceeds of the dollar loan would probably meet with little favor in the eyes of local tax authorities, apart from the illogicality of valuing, at a re-appraisal, similar assets on bases distinguished by a fortuitous circumstance, namely, availability or otherwise of domestic funds at a time when needed for plant requirements.

Revaluation Surplus

If the whole plant be revalued on the basis of the increased costs, a book surplus may easily result which is only partly offset by the exchange difference on the dollar loan, and the excess would fall into surplus, rendering the company liable to additional heavy taxation. In some countries, this tax would be levied even if the excess were placed to a reserve account and not treated as part of the surplus available for distribution; in France, for example, it might be taxed as an undistributed reserve.

Exchange Profits

Or again, a German subsidiary of an American concern may have borrowed from an American source prior to currency restriction and to dollar devaluation, an amount of, say, \$100,000. This would be entered in the books of the German company at the then equivalent of RM 420,000. If, after the introduction of restrictions and the devaluation of the dollar, the German company obtained permission to repay the loan, the amount of currency required might be only RM 249,000. There would be an apparent exchange profit to the German company. Latterly, the German Government decided that it is unfair for individuals or private concerns to make such exchange profits, and a law was introduced which confiscates such profits.

A more usual case, however, was that the German company would be permitted to make payment not in so-called "free Reichsmarks," but

in Sperrmarks which had a market value very much below the official Reichsmark exchange rate. A condition of the granting of such permission would be, however, that the foreign creditor should accept such Sperrmarks at the full official rate for free Reichsmarks, and regard his claim as cancelled to that extent. In that case, the German debtor would have to surrender his book profit and the American creditor would receive, for the Sperrmarks transferred in settlement, perhaps 20 per cent. of the original amount of his claim, but would have obligated himself to regard his debt as liquidated in full.

Control of Foreign Transactions

The implications of the term "currency restriction" are usually much more extensive than the literal acceptation of the words would appear to indicate. The primary object is, of course, to prevent immoderate offers for sale of the domestic currency by those who have lost faith in its stability. The first step, therefore, is to forbid the export of domestic currency, except for approved transactions. (It need not be stressed that "export" in this sense, need not necessarily involve the sending abroad of notes or coin.) The State must, therefore, institute a control to satisfy itself that all payments made abroad are in respect of transactions which the authorities consider legitimate.

But, as original sin persists even in those communities from which it has been officially banished, it will not be long before attempts are made to evade the restriction by exporting goods or services instead of money, and having the customer pay in foreign currency outside the country. To counter this move, the State requires from all exporters, details of their sales to foreign countries, and follows up the receipt of the sales consideration. If the sales price is received in foreign currency the State insists on the surrender of this money to the Treasury in exchange for domestic currency.

Another eventuality is that money may be smuggled out of the country by those who, proposing to emigrate, wish to have some capital at their disposal to start a new life, and who may sell it at cut rates to tourists or others entering or re-entering the country. The counter-move to that is to prohibit the import, as well as the export, of domestic currency, except such as is acquired in the form of checks from institutions approved by the State. This embargo is naturally extended from money to goods, except where a license is given; one of the reasons which is, perhaps, less obvious than some others, being that the foreign supplier may not choose to wait until the domestic authorities agree to payment being made, but may obtain satisfaction by distraining on foreign assets of the debtor (such as exported goods or resultant receivables in the foreigner's country)

which would otherwise have been realized by the debtor and placed at the disposal of his country's treasury.

Security Restrictions

Similar considerations lead to the ban on importing securities issued in the restricting country, but held abroad. It is manifest that the foreign owner, whose opportunity of either utilizing the income or disposing of the capital is restricted, will be willing to part with his holding at a lower price than would a resident in the restricting country. It follows that a profit could be made by purchasing domestic securities held abroad and selling them in the country of origin.

From the point of view of the foreigner possessing assets of any kind in a country where such restrictions operate, an important factor in putting a value on these assets will be the possibility of realizing the capital invested or at least utilizing the accruing income. That is, can any of it be remitted to him outside the country of the investment; if not, can he use it inside that country? And the latter question is really two: firstly, does he want to; secondly, will he be permitted to do so?

Assuming that, owing to special circumstances, he can use all the income, he may find that this itself has been restricted by law, as for example in Germany and Italy, where a maximum dividend is imposed. Thus, an investor who purchased stock in a German company on the basis of a series of 20 per cent. dividends might have felt inclined to revalue his holding on learning that the amount by which any dividend declared by his company exceeded eight per cent* had to be invested by an official Trustee on the shareholder's behalf for a period of years. The law of December 4, 1934, which introduced this enforced saving, provided that, on expiry of the period of saving, the proceeds of the securities which the Trustee had bought with the super-dividends, would be divided among the shareholders entitled to them in a manner to be fixed by the Reich Minister for Economics.

On December 9, 1937, a decree was issued giving the method in which these accumulated savings were to be distributed to the beneficiaries. Briefly, it provided that the government took over from the Trustee for the shareholders, at the current quotation, the securities which had been acquired with the super-dividends. In payment for these securities, the government would supply Tax Remission Certificates, which would be reckoned for this purpose at their nominal value. These certificates are to be accepted by the government at their nominal value, in payment of certain taxes,

* Normal maximum 6%; but 8% where previous dividends 8% or more—as in case quoted.

in the five years from April 1, 1941, to March 31, 1946; they are to be issued in blocks of five, one for each year. For the benefit of those who would rather have ready cash now than a tax reduction at a later date, the decree states that the certificates may be dealt in on any German Stock Exchange where, presumably, they will never be quoted at par; no one will pay a stockbroker to buy something, the only use of which is more conveniently met by a personal check, unless, as happened in the latest issue of Tax Remission Certificates, the government adds a premium to the face value, and accepts the certificates at the higher rate.

Clearing Arrangements

It may also be noted that exchange restrictions in one country may affect the relations between two other countries neither of which is directly subject to such impediments. Clearing arrangements are an obvious example where one country may have agreements with a number of others and where none of these others may purchase the products of the one country, except from it directly.

A less obvious case is that where a concern has established a subsidiary in one foreign country and later caused that subsidiary to create a subsidiary of its own in a third country. The country in which is domiciled the first subsidiary later decides to introduce currency restriction. The second one does not, but nevertheless the original parent concern may find its dealings with the second subsidiary restricted by the control of the first subsidiary over the second, the exercise of such control being enforced by the authorities in the country in which the first subsidiary is domiciled.

Quite a number of questions are raised by the mass production of social legislation, a result of which has frequently been to increase the costs of labor and reduce its productivity. For example, the selection of a basis of inventory valuation, in such circumstances, and where labor costs form an appreciable portion of the whole is not always a simple matter. Further, the extent to which effect should be given in the accounts to the obligations laid on the employer in various eventualities, should the employer not be insured against these, is also a matter for consideration.

Still another development to which consideration must be given is the increased measure of power which recent totalitarian legislation has conferred on the executive of public companies, by which the executive is under no obligation to bow to the wishes of either board or stockholder majorities. There are, of course, certain restrictions possible, but it appears that in a conflict between stockholders' and various other interests, the stockholder is the stepchild. As one authoritative commentary puts it: "The executive must carefully weigh the de-

mands of the welfare of the labor force, as well as the general demands of the welfare of people and country, against the private interests of the company as such, and of its stockholders; the former must be given priority, on suitable occasions the latter should not be ignored."

Diversity of Languages

Turning to problems created by nature rather than by man, it is frequently assumed that one of the principal difficulties encountered in a continental European practice is the diversity of tongues in that territory. Undoubtedly, a knowledge of the more widely spoken languages is always desirable and occasionally necessary, and in selecting staff, the advantage of having available men with a variety of second languages is borne in mind. But, in the case of the less widespread tongues, one usually finds that the business men of the countries concerned speak at least one of the "world languages." This is particularly so in businesses with which the auditor representing foreign interests will come in contact: the Rumanian business man, for example, who wishes to devote himself to international trade, realizes that it will be better for him to learn, say, English, rather than wait for his English speaking customers to learn Rumanian.

Apart from this, the auditor deals, to a great extent, with an international language: figures written in Sofia will be understood in San Francisco; a debit is the complement of a credit in Belgrade as in Birmingham (England or Alabama).

It will thus be realized that mere differences of language are among the minor troubles. But, the curse of Babel is a much deeper thing than that, and more important than variety of tongues is divergence in habits of thought, calling for a knowledge of types and the exercise of tact greater than that normally required when working with those of one's own country. Particularly is this the case when the audit is not an established institution. For example, the suggestion that requests for confirmation of balances should be posted by one of the auditor's staff rather than by a member of the client's organization, and that the confirmations should go direct to the auditor and not to the client's office, must, on occasion, be carefully framed if it is not to be interpreted as an insult. Examples might be multiplied.

Within the limits mercifully set by the editor, it is impossible to do more than touch on one or two of the problems confronting the auditor in continental Europe, but enough has probably been said to show that monotony need be no part of his lot.

PARIS, FRANCE.

The Growth of the Accounting Profession in France

By L. C. David

Up to 1935, there had been no official recognition of an accounting profession in France, either from the point of view of a corporate body or from the point of view of standard professional capacity.

The basic law relating to Limited Corporations, Partnerships, etc., was framed in 1867. In the intervening years up to 1935, there had been some amendments, but nothing of startling nature. In the 1867 Act, mention was made of the accounts of a Corporation being certified by a "Commissaire"; no definition however was given as to who the "Commissaire" should be or what technical knowledge he should possess in order to certify the accounts of a Corporation. In fact, the "Commissaires" of the majority of Corporations have consisted of clerks or friends and relatives of the Board of Directors possessing no accounting knowledge of any kind.

As far as accounting training went, many schools existed in France and there were various bodies of so-called "Experts-Comptables," but here again there was no standard by which the capacity of these "Experts-Comptables" could be measured.

In 1927, the French Government attempted to remedy this situation by the issuance of special licenses to "Experts-Comptables" who were capable of passing the examinations set by the State. These examinations were however of such a high standard that the number of successful candidates was totally inadequate to supply the needs of all the Limited Companies (Corporations) existing in France. In the early thirties a series of financial scandals broke out in France, with the result that a growing body of public opinion clamored for reform of the Corporation laws. After several years of discussion in both the "Chambre des Députés" and the "Sénat" many amendments were passed to the old 1867 Corporations' law, and included in these amendments was a tightening up of the control of Corporations by the "Commissaires."

The following is a brief commentary of the amendments of the 1867 Corporations' law as affecting Auditors:

August 8, 1935:

Preferential rights given to existing Shareholders to participate in new issues of shares.

October 30, 1935:

Regulations regarding the issues of bonds.

June 29, 1936:

Regulations regarding the choice of persons to be placed on the list of accountants mentioned in the decree of August 8, 1935.

June 12, 1937:

Further regulations regarding the choice of persons to be placed on the above mentioned list.

August 31, 1937:

Regulations regarding voting rights to Shareholders.

August 31, 1937:

The Ordinary General Meeting of Shareholders to appoint one or more Auditors for a period of three years with a mandate to examine the books of the Corporation. This mandate consisted of a verification of the books, the cash, the portfolio of the Corporation, the investments of the Corporation, to control the correctness of inventories and balance sheets and the correctness of the report made by the Board of Directors on the Corporation.

August 8, 1935:

The Auditors may examine the books of the Corporation any time of the year and may call a General Meeting of the Shareholders, if necessity arises.

These decrees show, in general terms, some of the reforms carried out. It is interesting, however, to follow these up in detail and to explain how the decrees are to function.

The following gives in greater detail the application of the decrees.

Act of 1867—Paragraph 33—August 8, 1935:

The following persons may not be auditors of a Corporation:

1. Relatives up to the fourth degree of Directors.
2. Persons receiving in one form or another a remuneration other than as Auditor from a Director or from the Corporation or from a business possessing one tenth of the capital of the Corporation, or from any business of which the Corporation possesses one tenth of the capital.
3. Any person exercising the function of Director.
4. The husband or wife of any of the persons mentioned above.

Paragraph 33—July 30, 1937:

No person included in the official list of Auditors may act as a Director of a Corporation and no Auditor may become a Director within five years from the expiration of his appointment as Auditor to any particular Corporation. This restriction to become a Director applies also to Corporations which are related by sharehold-

ing to the Corporation in question, as mentioned in paragraph 2 of the preceding decree.

Paragraph 34—August 8, 1935:

At the end of each year of the Corporation, the Board of Directors must prepare the accounts of the Corporation and make a report to the Shareholders on the Corporation. These accounts and report must be placed at the disposition of the Auditor at least 40 days before the Annual General Meeting. The Auditor will then report on his examination and also will make a special report on any business carried out between the Corporation and a Director. A Director is required to disclose to his Board any transactions he may personally carry out with the Corporation, and must obtain approval of the Board.

Paragraph 35—October 30, 1935:

The accounts of the Corporation, as presented to the Shareholders, must be in the same form as in previous years. The methods of valuation of various items in the accounts must remain unchanged, unless the General Meeting having had regard to reasons set out in the Auditor's report, approve of a change. The Profit and Loss Account must indicate separately each source of income.

Paragraph 57—October 30, 1935:

When a Corporation is formed, among various details to be set out in the registration with the Tribunal of Commerce, are: the name, profession and personal address of the Auditor.

Paragraph 7—August 8, 1935:

In the event of an increase in the capital of a Corporation, the Shareholders have preferential rights of Subscription, and the Auditors must make a separate report to a General Meeting, indicating whether in their opinion, the basis of calculation for the price of issue of the shares is a correct one.

Paragraph 6—August 8, 1935:

Condemnation by any Court for infraction of penal laws, disqualifies a person from being placed on the official list of Auditors.

Decree 29—June 29, 1936:

"This was a very important decree concerning Auditors as listing the qualifications necessary for admittance to the official list.

"As has happened in other countries, where a sufficient number of qualified persons did not exist, in order to set up a body of professional standing, the first members to be admitted on the official list were chosen from a wide group and consisted of the following:"

1. Possessors of the license given by the State under

the decree of May 22, 1927.

2. Retired Civil Servants having had at least ten years' public experience and who possess the necessary aptitudes to audit Corporations.
3. Accountants and Financial Experts who have been attached for at least five years to a Court of Appeal, or a Commercial Court as Consultants.
4. Persons who had at least ten years practical, commercial, industrial or accounting experience, provided they have been members of a State Institute of engineering, actuarial science, finance, political science or commerce.
5. Persons who have in their own capacity acted as Accountants for ten years, who are taxed under the license tax as such; also those who have for ten years been members of a firm specializing in auditing on condition that in both cases, the person has held the appointment of an Auditor (Commissaire) for at least five years.
6. Persons who have been in charge of the accounting, financial or legal department of a Corporation and who are considered by the Examining Commission as qualified to be placed upon the list.
7. Persons who have fulfilled two of the three functions mentioned in paragraphs 5 and 6 provided the total period in which they have carried out these functions exceeds fifteen years, and who have for at least five years held the appointment of Auditor of a Corporation.

In the latter part of this decree, it was stated that the nationals of countries where French nationals are allowed to carry out the function of auditors, would be allowed to appear on the official list providing they fulfilled the conditions specified above. Under this proviso, it has been possible for some of the English Speaking Accountants practicing in France, members of the British and American Institutes, to be admitted on this list.*

The decree then goes on to state the further regulations to be carried out by persons coming within the

* It will interest the members of our organization in America to know that both of our partners at Paris, Messrs. O'Dea and David, are on the accredited list.

above mentioned categories. These are:

1. A technical examination.
2. Presentation of legalized copies of any diplomas.
3. Birth certificate.
4. Copy of the applicant's police dossier.

Further, the candidate has to satisfy the commission of his good standing and is interviewed by the judicial police.

The candidate, when admitted, is placed on a list attached to a Court of Appeal of the District where he resides.

There are many Courts of Appeal in France and each Court has its list, but any person appearing on one list may, upon application, be placed on another list.

As mentioned above, a candidate is expected to pass an examination, but owing to the lack of a sufficient number of qualified Accountants, no examination was necessary for those accepted on the first issued list.

A new list is prepared every year and a person once on the list continues to be on the list every year, unless he resigns or is eliminated for unprofessional conduct.

The examination covers quite a large amount of detail and certainly necessitates several years' study. A rough translation of the syllabus shows that there are three papers on Accountancy covering general principles, application to different types of enterprises and application to different types of legal entities.

There are two papers on financial mathematics and financial theories and three papers on general commercial laws, penal laws relating to Corporations, and fiscal laws relating to Corporations.

Finally, the decree stated that, as soon as this list was established, each group attached to a Court of Appeal, should form itself into a disciplinary body and function in the normal way of professional bodies, that is with Statutes and Governing Committees, with yearly subscriptions for members.

There are therefore two bodies now in existence:

1. An official commission permanently sitting, consisting of a President of a Court of Appeal, a Magistrate of the Local Commercial Court, a President of the Local Chamber of Commerce and the head of the Regional State Department of Corporation Registration.

   This commission is responsible for the acceptance or refusal of candidates.
2. The second body or bodies will consist of Societies of Accountants of each district where there is a Court of Appeal.

It is very evident that later on, there will be only one central body of Accountants responsible for the discipline of the profession and the upkeep of professional dignity.

The profession is now on its way

(*Concluded on page 75*)

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. & Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest, and to help in the solution of common problems.

A Further Anniversary Number

As all the members of the L. R. B. & M. organization know, the September issue of the L. R. B. & M. Journal was devoted to a group of articles by Mr. T. Edward Ross, which presented the history of our firm since its founding in 1898. The present issue is in the nature of a supplement to, or Part II of, the Fortieth Anniversary Number of our Journal.

A number of members of our firm have prepared brief articles in which they present thoughts and comments on varied subjects, including taxation, accounting problems in certain lines of business, and other matters which have come particularly within the ken of the writers during their professional experience. It is be-

lieved that these articles to the JOURNAL will form a fitting contribution to the record of the recognition of the fortieth anniversary of the founding of our firm.

Because of the brevity of these articles, it is obvious that they are not intended to be complete or exhaustive presentations of the subjects with which they deal. Their purpose is rather to point out special features of such subjects which may be of interest to the business man or the accountant.

Tax Handbooks

The new edition of *Federal Tax Practice,* prepared by Colonel Montgomery, with the collaboration of Messrs. Haynes, McGuire, Magathan and Wynn, came from the press during the past month.

The 1938-39 editions of Colonel Montgomery's *Federal Income Tax Handbook* and *Federal Taxes on Estates, Trusts and Gifts* are expected to be ready for distribution by the end of November.

Changing Custom

Another indication of how times have changed, and with them long established practice, is the consideration which is being given to a possible revision of the rules of the New York Stock Exchange in respect of the form in which its members may do business. Throughout the history of the Exchange its members have been permitted to carry on their business only in either individual or partnership form. Incorporation of the business of stock exchange firms was not permitted.

Several months ago, however, tentative rules were submitted for the consideration of the board of governors of the Exchange which would modify the long established rule and permit member firms to incorporate. Just as this issue of the JOURNAL is going to press, the report of a special committee which has been studying the subject of permissive incorporation was made public. Various criticisms of the proposed rules permitting incorporation have been considered by the committee, and six changes in the proposed rules are recommended by the committee to meet the criticisms.

From the discussion of the subject which has appeared in the newspapers, including the attitude of the Securities and Exchange Commission, it appears quite likely that incorporation by its members will eventually be permitted by the Exchange. If and when this occurs, another major change will have taken place in the customs of the financial world.

Notes

The annual firm meeting, when partners and representatives of the staff from the various offices gather for two days of business and pleasure, was held at the Seaview Golf Club in Absecon, N. J., on October 3d and 4th. Monday afternoon and evening, and Tuesday afternoon until almost the time of leaving for homebound trains, were devoted to sessions at which numerous practical problems were discussed.

The mornings of both Monday and Tuesday were devoted to the annual firm golf tournament. The L. R. B. & M. cup was won by Mr. A. J. Starr with a total low net of 142 for the two days. The cup will therefore remain in the custody of the Cincinnati office until the next annual meeting. Others who made prize-winning records were as follows:

Low Gross	Total Both Days	F. S. Metzler (Philadelphia)	173
		A. G. Moss (Dallas)	173
Low Gross	First Day	R. S. McIver (Philadelphia)	87
Low Gross	Second Day	S. B. Ives (Atlanta)	83
Low Net	First Day	A. R. Jennings (New York)	71
Low Net	Second Day	C. W. Schelb (Chicago)	71
Kickers' Handicap	First Day	M. A. Yockey (Detroit)	70
Kickers' Handicap	Second Day	J. Hood, Jr. (Philadelphia)	70
		F. C. Dennis (Cincinnati)	70

In awarding the prizes, Colonel Montgomery named for Honorable Mention Messrs. Dennis and Tufel, each of them having had a low net score of 143 for the two days.

When Mr. Fischer reached his office on November 16th he met with a very pleasant surprise in the form of a Helmsmen's Wheel Clock with ship's bell strike, and a bouquet of thirty American Beauty roses, to say nothing of many congratulatory cards. November 16th marked the thirtieth anniversary of his association with the firm.

A number of members of our organization participated in the annual meeting of the American Institute of Accountants held at Cincinnati, Ohio, September 26th to 29th. Mr. Staub spoke on "Uniformity in Accounting," a subdivision of the general subject, "A Statement of Accounting Principles," to the consideration of which both the morning and afternoon sessions of the 29th were devoted. Mr. Dennis, manager of our Cincinnati office, was Chairman of the Reception Committee, and Mr. Warren, in addition to being a member of that Committee, acted as toastmaster at the annual

banquet. Messrs. Starr, Seifert and Schmidt, of our Cincinnati office, also served on the committees responsible for the arrangements which resulted in an excellent technical program and most pleasant entertainment for those in attendance.

The November issue of *The Certified Public Accountant* announces the appointment of committees of the American Institute of Accountants for the institute year. Members of our firm will serve on the committees named below:

Mr. Ross:
  By-Laws
Colonel Montgomery:
  Executive
  Nominations
Mr. Staub:
  Accounting Procedure
  Cooperation with Stock Exchanges
  Public Utility Accounting
Mr. Dumbrille:
  Stock Brokerage Accounting
Mr. Sweet:
  Cooperation with Securities and Exchange Commission
Mr. Keast:
  Meetings
Mr. Sinclair:
  Publication
Mr. Lenhart:
  Inventories
Mr. Taylor:
  Cooperation with Credit Men

Influences on the Development of Investment Company Accounting

(*Continued from page 48*)

financial statements of companies qualifying as "Mutual Investment Companies" present a different picture as to tax expense from those of companies not in that classification.

Perusal of current financial reports of representative American investment companies indicates generally that they have been prepared with the purpose of giving security holders adequate and comprehensible information as to the operations and position of the companies.

BOSTON, MASS.

The Growth of the Accounting Profession in France

(*Continued from page 71*)

to being organized and although recognized accountants appearing on the official list must be employed only in the case of public corporations, the penalties attached to the failure of a person carrying out the duties of auditor to a private corporation are such that any unqualified person will be deterred from doing so.

PARIS, FRANCE.

Lybrand, Ross Bros. & Montgomery

Offices

Cities	*Addresses*
NEW YORK:	Downtown, 90 Broad Street
	Uptown, 1 East 44th Street
PHILADELPHIA	Packard Building
CHICAGO	231 South LaSalle Street
BOSTON	80 Federal Street
BALTIMORE	First National Bank Building
WASHINGTON	Investment Building
PITTSBURGH	Union Bank Building
DETROIT	Book Building
CLEVELAND	Midland Building
CINCINNATI	Carew Tower
LOUISVILLE	Heyburn Building
SAINT LOUIS	411 North Seventh Street
ROCKFORD	321 West State Street
ATLANTA	Healey Building
DALLAS	First National Bank Building
HOUSTON	Shell Building
SAN FRANCISCO	2 Pine Street
LOS ANGELES	510 South Spring Street
SEATTLE	Skinner Building

EUROPE

LONDON, ENGLAND	3 St. James's Square, S. W. 1
PARIS, FRANCE	3 Rue des Italiens